

BUDGET REFORMS

HEARING
BEFORE THE
COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ONE HUNDREDTH CONGRESS
SECOND SESSION

JUNE 7, 1988

Printed for the use of the Committee on Governmental Affairs



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BUDGET REFORMS

TUESDAY, JUNE 7, 1987

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in room 342, Dirksen Senate Office Building, Hon. John Glenn (Chairman of the Committee) presiding.

Present: Senators Glenn, Sasser, Pryor, Roth, Stevens and Heinz.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The hearing will be in order. Today we continue the Committee's work on ways to improve the Federal budget process. This Committee was one that authored the 1974 Budget Act and maintains a long-standing interest in budget reform.

There is no question the budget process is very frustrating. We spend a great deal of time on the budget, yet we routinely miss deadlines and the deficits remain large. We exert a tremendous amount of effort to allocate resources fairly and efficiently, yet most members complain we are not making the right choices.

Indeed, a recent survey by the Center for Responsive Politics suggested as many as two-thirds of our colleagues here in the Senate believe that the current budget process has weakened their respective Committees' ability to make policy. The important question, however, is not whether the process is frustrating, but whether it has broken down completely and if so, how can we fix it.

By itself, budget reform will not create the political courage to make tough choices. Nevertheless, budget reform can create a greater presumption in favor of lower deficits, whether by making the presentation of budget information more meaningful, the process of budget choice more useful, or the monitoring of budget performance more effective. These three P's—the presentation, the process and the performance provide the basis for meaningful budget reform.

We will hear testimony today on three basic questions. First, does the budget itself make meaningful distinctions on the kinds of choices Congress and the President must make? Some who have studied the budget structure argue that we should distinguish capital investments from operating expenses as the private sector does.

Others suggest that we divide the budget into trust fund versus non-trust fund expenditures. While these ideas have some merit, we must be careful not to create new ways to avoid choices. The

capital budget makes little sense if it merely becomes a way to hide the deficit.

Second, does the budget process provide appropriate incentives and opportunities for careful choices? Clearly, we have a great many votes on the budget each year. The problem is that some do not matter and others come late. The two-year cycle has great appeal to those who believe Congress and the President need more time to think and to do an oversight function.

It also has appeal for Federal managers who must wait until the last possible moment for their budgets. Before moving forward, however, we must address what appear to be serious obstacles to successful biennial budgeting. A biennial budget process must cover both authorizations and appropriations, not just one or the other.

A biennial budget process must also be responsive to changing conditions. Given our inability to forecast much past next week, let alone for two years, the biennial process must be sufficiently flexible to keep up with forecasting mistakes and new policy problems.

Third, does the current system provide for effective financial management? Do we do a good job of tracking the dollars? Do we make sure programs perform as promised? The answer is clearly no. Our financial systems have improved somewhat over the past year, but they remain a mass of uncoordinated, antiquated systems which do not produce comparable information on how Government programs are working.

Just about a year ago we held a hearing on legislation to create a Chief Financial Officer, a CFO, in the Executive Branch. The President created a CFO of his own that day and OMB Director Miller assured this Committee that the new CFO would be a household name within weeks. Unfortunately, according to the General Accounting Office, that just has not happened.

Despite the promises, the CFO is behind schedule and will need more time to meet the deadlines we were told would be met by now. According to the timetable that the Deputy Director of OMB presented at that hearing, core requirements for agency financial systems were to be done by August last year. They were finished the following January.

A schedule of qualified vendors was to be available by February of this year. We are still waiting. A standard general ledger was to be in place in all agencies by October, 1988. The President's management report now says some will not be done until 1990 and 1991. All agencies were to implement primary accounting systems by the end of 1988. The President's management report now tells us 1992 is more reasonable.

To top it off, just last April, the Deputy Director of OMB promised that the President would soon send Congress a legislative proposal for the creation of a CFO by statute. Such a proposal would clearly strengthen the CFO's authority in dealing with agencies. Unfortunately, we are still waiting for that, too.

I do not want to denigrate the efforts of the current CFO, Jerry Rizo and those who are helping him move forward. However, it is time to give the CFO the resources and the clout to get the job done. I know the distinguished former Chairman of the Committee

shares that sentiment. We have been working on this issue together for some time.

I believe that financial management is a key part of budget reform. The lack of good cost data at the front end of the process and the inability to track expenditures at the back end undermine everything that happens in between. Along with our focus on presentation and process, we must also place appropriate emphasis on performance and that means having the systems and the leadership to keep track of what we are spending.

That is also why I have long advocated an amendment, currently numbered S. 86, to change the budget process to require that the President must either send us a balanced budget or tell us how to get there. This proposal has passed the Senate twice and deserves our renewed attention. To me, this is a truth in budgeting approach that has great merit as a part of any budget reform package.

We are glad to take up this matter this morning of the biennial budgeting and those who are proposing it, interested in it, are here to give us their testimony on it. We have the section-by-section analysis of the Act as proposed here that the Committee has gone over and I believe that is available for everyone this morning.

Senator Stevens, any comments?

OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. Thank you, Mr. Chairman. I commend you for holding the hearing and I welcome our two colleagues. I have cosponsored the original bill that Senator Ford introduced. I have some serious questions about this one, however, and I think that we have to raise the question of whether Committee re-alignments must precede the kind of drastic change that this bill suggests.

Maybe I should say we should have some Senate perestroika in the whole concept here of restructuring. But as a practical matter, the two-year budget cycle makes a lot of sense. The difficulty that I have here is, is that I think in the last three years, we have not had an authorization bill in time to complete the appropriations cycle. There is no question about that.

But even with the authorization bill in the preceding Congress, I am not sure that it is possible for us to have a concept of having 13 appropriations bills completed in the one year for a two-year process and then not touch appropriations again for two years. It does seem to me that the real problem here is the realignment of the Committee structures first in order to get to the concept of a two-year cycle that is meaningful.

One quarter of the Senate or more is involved in the appropriations process. That seems to be the whipping boy as far as these concepts or reforms right now. Maybe I am taking this too much as a defensive mechanism—too much the defensive for the appropriations process that I have been part of now for almost 20 years.

But it does seem to me that the real problem is in the authorization process as well as the appropriations process and I am not certain that this draft here presents us the solutions for that unless we do, in fact, totally review and restructure the Senate Committees. There are proposals for that. Senator Kassebaum has one that

the Rules Committee has heard and I think a great many of them make some sense.

I do believe that we should try to get to a two-year budget cycle. Whether this proposal is the way to get there is the problem that I have. I am sorry that I do have to go to Defense Appropriations as I would like to stay and hear the presentation of it. I look forward to reading it, though, and I will do that. Thank you very much.

Chairman GLENN. Thank you, Senator Stevens. Senator Sasser.

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Thank you, Mr. Chairman. First, I would like to express my appreciation to you, Mr. Chairman, for scheduling this hearing to draw attention to the whole question of budget reform. The focus of the Governmental Affairs Committee on the stalemate that has existed between the Administration and the Congress, even, we have seen in recent months, between both Houses of Congress, will hopefully provide us with ideas and insight in our search for problem solving solutions.

One thing is certain—business as usual is not an acceptable alternative as far as the budget process is concerned. Currently, the process is complicated. It is a frustrating process with mandated deadlines that are often times missed or even completely ignored altogether. This is allowed to continue at the expense of deficits and also at the expense of vital programs such as health care for older citizens, cleaning up the environment, and other very, very vital programs.

We are here today, Mr. Chairman, in search of alternatives and I am pleased to see that our distinguished ranking member, Senator Roth, is taking the lead in helping us find some of these alternatives. But we must keep our mind open to all options and readily explore every avenue in an effort to reform the budget process.

Now, there exists a wealth of ideas, legislative proposals to solve this dilemma. One thing about this city, the Nation's Capitol, there is never a dearth of ideas here or what to do about them, but whether we move to biennial budgeting or further Congressional restructuring of the budget process, changes in Congressional Committees, or realistic budget forecasts, or an enhanced role by the Administration, each, I think, of these alternatives deserves full attention and consideration.

But the problem is that reaching a consensus will not be easy. As we hear from these distinguished panels today, we have allowed this budget process, they will tell us, to become more burdensome and more cumbersome with each fiscal year, which only makes us more acutely aware of the tremendous task that we have before us. I do think that there may be some light at the end of the tunnel and I remain hopeful that a bipartisan agreement can be reached because if the budget process is to ever work efficiently, it must be a bipartisan process.

Mr. Chairman, I think you pointed out that the Governmental Affairs Committee authored the 1974 Budget Act, which has served us well, but it needs an overhaul. I do not think there is any doubt of that. We did pass the Gramm-Rudman-Hollings Act, for better or worse, in 1985 and that has forced us to make some difficult de-

cisions in this budget process with automatic sequestration always being an ongoing and unpalatable option.

Mr. Chairman, I join members of the Committee in welcoming today our distinguished friend from Kentucky, Senator Ford. As I said before, I am heartened that the ranking member of this Committee is taking the lead in trying to shed some light on the nagging problem of what is to be done about reforming the budget process and making it more efficient and more meaningful. Thank you.

Chairman GLENN. Thank you very much.

Senator Nunn is unable to attend today's hearing and has a statement and asked that it be accepted for the record.

OPENING STATEMENT OF SENATOR NUNN

I regret that I am unable to attend today's hearing; however, I appreciate the opportunity to share my views on this important legislation.

I want to lend my strong support to efforts to establish biennial budgeting. As many know, the Armed Services Committee required the Department of Defense and related agencies to submit a two-year defense budget last year, and the Congress enacted it last year for the first time. It was a partial effort, but it certainly was a step in the right direction.

I applaud and support the efforts of Senator Ford and others who have been leaders for years in an effort to apply the two-year concept to the entire federal budget. I especially applaud him for making it a comprehensive biennial proposal—including the budget resolution and most importantly the appropriations bills. Ultimately, biennial budgeting will fail if there are no new two-year appropriations bills.

I do have some concerns about the timing sequence in the Ford bill, as it does not fully recognize the current way the defense authorization bill is handled, particularly with our experience as a two-year authorization. I believe, however, I can work with Senator Ford and others to modify the bill in order to take care of those concerns.

Chairman GLENN. We do have a long witness list today. We have four Senators: Senators Ford, Roth, Domenici, and Kassebaum. We have the Honorable Charles Bowsher, Comptroller General, and from the House, Congressmen Rhodes and Giaimo and former member of the House, Jim Jones, who was formerly the House Budget Committee Chairman. We have Jim Miller, Director, Office of Management and Budget and Robert W. Helm, Comptroller, Department of Defense. So, we have a long witness list today.

Senator Ford, we will ask you to lead off if you will. I know you have been interested in this a long time. You have had this bill in and have been a real proponent of the biennial budgeting. We are glad to hear your testimony this morning.

TESTIMONY OF HON. WENDELL FORD, U.S. SENATOR FROM THE STATE OF KENTUCKY

Senator FORD. Thank you very much, Mr. Chairman. First, let me add to what others have said to thank you for scheduling this hearing on budget reform. As you know, since 1981, I have been pushing the idea of moving the Federal budget to a two-year cycle. It looks like this idea's time has finally come.

In his budget message this year, President Reagan called upon Congress to adopt a biennial budget. The U.S. Chamber of Commerce has endorsed the idea and just last week, at hearings before the National Economic Commission, there was uniform support expressed for moving to a two-year budget, as a procedural change

which would assist Congress in our efforts to address the budget deficit.

In the interest of time, Mr. Chairman, I will summarize my statement and submit the full text for the record with your approval.¹

Chairman GLENN. Without objection, the full text will be included in the record.

Senator FORD. I thank the Chairman.

I am particularly pleased to appear before this Committee today to discuss legislation which Senator Roth, Senator Kassebaum and I will be introducing later today, the Biennial Budget Act of 1988. This legislation is a melding of Senator Roth's legislation and my earlier two-year budget bill and reflects the changes that have been made in the budget process in recent years.

I would like to commend, publicly here this morning, my colleague, Senator Roth, for suggesting that we develop this bipartisan bill. His expertise and long-standing interest in a two-year budget process is an asset to this Committee and to the Senate and it is my privilege to co-author this legislation with him. It is our hope that this bill can become the vehicle for discussion and reform and that the Committee will be able to consider our proposal yet this year.

I have provided to you and your staff a detailed summary which you referred to earlier, which gives a section-by-section analysis of our proposal and I ask also, Mr. Chairman, that that be made a part of the record² and I will just highlight our proposal.

Chairman GLENN. Without objection, it will be included.

Senator FORD. I thank the Chairman.

First, let me point out that this is not an anti-Gramm-Rudman-Hollings bill. All the discipline of the Gramm-Rudman-Hollings is left in place. The major changes made to the Budget Act by Gramm-Rudman-Hollings, such as the change from a two-resolution system to a one-resolution system are retained.

Second, enactment of one budget resolution, appropriations covering two fiscal years and reconciliation are all completed in the first session of each Congress. The second session of each Congress will be devoted to authorizing, oversight and compliance reviews, containing all the major budget and appropriations decisions in one session. It will give Congress and the Executive agencies the time to conduct the oversight and compliance review necessary to make informed budgetary decisions.

Third, the bill provides for permanent, continuing appropriations in the event that Congress and the White House do not complete action on all individual appropriations bills before the beginning of the biennium. Programs funded in the previous biennium will continue to be funded at the same rate of operations and will be superseded by the enactment of the regular appropriations bill and that is, as it currently is the case.

The permanent continuing appropriations authority is limited to one biennium period. While a two-year budget cycle will ultimately assist Congress in meeting its deadlines, this permanent continuing

¹ See p. 57.

² See p. 62.

appropriations provision eliminates the very time-consuming process of enacting a continuing resolution and removes the ability to fill a veto-proof bill with spending programs that bust the budget.

Fourth, the bill contains some features of my original bill, designed to strengthen the ability of committees to obtain information about the operation and effectiveness of a Federal program. Also proposed is a requirement that there be consistency in the way budgetary information is presented by all the participants in the process.

Budget-related bills must include tables, setting forth the budget information at the account level using uniform accounts. This uniformity will allow efficient tracking and comparison of spending decisions.

Finally, Mr. Chairman, with the optimism that this proposal can be enacted this year, we provide that the process take effect in the next Congress. FY 1989 would be a transition year of single-year appropriations, and would also serve as the initial authorizing period for the biennium which would begin on October 1, 1989. By enacting this proposal this year, we give the new Administration advance notice of the new process and take advantage of the changing leadership in Congressional committees to smooth the transition to reform.

Biennial budgeting is not a panacea for our Federal budgetary problems. But it is a tool which can make the Federal Government operate more efficiently and allow Congress the time to make considered and informed budgetary decisions. Biennial budgeting will provide greater funding stability and certainty for our elected counterparts in State and local governments and for the numerous beneficiaries of Federal funds.

As a former Governor, I know the benefits of having sufficient lead time on Federal spending programs and the cost savings that can come from being able to plan two years in advance.

The budget summit last year gave us an opportunity to get our feet wet with two-year budgeting and the success thus far of that exercise indicates that it is now time to take the plunge. Our legislation is a bipartisan approach to biennial budgeting. We are committed to working with our colleagues and this Committee and the Budget Committee to produce a workable biennial budget bill.

Mr. Chairman, I appreciate the opportunity to testify this morning and will be pleased to attempt to answer any questions or might even accept the names of some co-sponsors that would want to step forward this morning. Thank you, Mr. Chairman.

Chairman GLENN. You are big of heart this morning.

Senator Roth.

TESTIMONY OF HON. WILLIAM V. ROTH, JR., U.S. SENATOR FROM THE STATE OF DELAWARE

Senator ROTH. Thank you, Mr. Chairman.

It is a great pleasure for me to share today's platform with our distinguished colleague from Kentucky, Senator Ford, who was the very first to introduce a two-year budget bill in 1981. I want to congratulate him publicly, both for his perception and foresight. His dedication to this idea has perpetuated the notion that this is good

reform. I think he is correct when he says that this is an idea whose time has come and the reason I think that is true is because of his strong leadership in this area.

Now, in each of the last four Congresses, Senator Ford and I have introduced differing versions of two-year budgeting. In an effort to further the cause in which we both believe in so strongly, we are joining our efforts. Later today, we will introduce a new two-year budget bill, one which we think combines the best aspects of our two approaches.

I firmly believe, Mr. Chairman, that the time for two-year budgeting has arrived; 20 Senators have co-sponsored such bills together. I might say that 20 of us have more than 200 years of experience in planning and voting on Federal budgets and we think it is time for a change.

A January survey by the Center for Responsive Politics revealed that an overwhelming 85 percent of House and Senate members said they would prefer a two-year cycle. President Reagan has urged Congress to adopt the two-year budgeting and backed the idea by submitting a two-year budget for the Department of Defense.

Both the Chairman and the ranking member of the Armed Services Committee, Senators Nunn and Warner, strongly praised this approach. The biennial budget of 1988 is designed to put the Federal budget on a two-year basis; it would create a two-year authorization, budget resolution and appropriations cycle. The first session of each Congress would be devoted to the budget resolution and appropriations, culminating with a two-year budget effective that October 1st.

The second session would be devoted to oversight; multi-year authorization for the next two-year period. Now, we all recognize that the Federal budget is one of the most important issues the Congress considers. Indeed, it represents the field where the struggle between differing views about the proper role, size and responsibility of Government occurs. Yet, for all the time and resources spent developing the budget, it seems more often than not that the hard decisions are made in the late hours of the night and quickly pass without due consideration.

During the last several years, the process has resulted in constantly missed deadlines and the need to reinvent the wheel every time a budget resolution, authorization measure, appropriations bill, or continuing resolution comes along. Putting the process on a two-year time table will enable the Congress to give a more careful look to the priorities incorporated in the budget, as well as giving the Congress more time to devote to other important issues.

Perhaps one of the strongest arguments for two-year budgeting is the budget summit agreement reached last December. By laying the foundation for a two-year budget, the process appears to be moving along much more smoothly than in recent years. Despite the delay in completing the budget resolution, the Appropriations Committees are hard at work and I am optimistic that for the first time in many years, the Congress will send the President individual appropriation bills before the beginning of the fiscal year.

There is no question that the Budget Act of 1974 was a major improvement over what had been a virtually uncontrollable and

haphazardous process. The 1974 Act provided the Congress with a mechanism to formulate and evaluate an overall fiscal strategy. It helped put individual appropriation bills into perspective regarding the entire budget. Yet, while it strengthened the Congress' hand in making budget decisions, it weakened the ability of Congress to get its work done efficiently and effectively.

I strongly believe, Mr. Chairman, there are many advantages to moving to a two-year process. In general, two-year budgeting would improve Congressional control over the Federal budget process; promote better accountability to the public by making clear our spending and budget priorities.

Because the Congress cannot get its work done on time, we end with massive continuing resolutions containing the entire Federal budget. Insufficient understanding of the continuing resolution by both the membership of the Congress, as well as the general public does very little to inspire confidence in the budget process or promote accountability of our decisions.

The result is increasing frustration on the part of the membership and the American people. We can reduce the repetitive decision making structure in Congress. We can strengthen the oversight and authorizing functions of the standing committees. We can provide greater certainty to program administrators and beneficiaries, such as State and local governments. But to do all of these things, we must reform the budget process.

The present budget process fosters uncertainty in the financial markets, creates budget instability for recipients of Federal funds, results in redundant Congressional action on budget matters, encourages the use of budgetary gimmicks and focuses attention away from developing our long-term national priorities.

I firmly believe a two-year process would help solve all these problems by providing Congress with more time to thoroughly consider budget matters and by providing recipients of Federal funds greater assurance that such funds will be available.

Lastly, Mr. Chairman, a biennial budget could help to moderate Government spending by forcing the Congress to abide by its budget decisions. To the American people, Congress appears hamstrung by its own procedures and unable to cope with the most urgent fiscal problems of the Nation. We owe it to the American people to reform the process. A two-year budget cannot substitute for political will to reduce the deficit, but it does provide an effective means to help get our fiscal house in order and I urge our Committee to consider and approve this legislation.

Chairman GLENN. Thank you, Senator Roth.

Senator Nickles, glad to have you join us.

Senator Nickles.

TESTIMONY OF HON. DON NICKLES, U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator NICKLES. Mr. Chairman, thank you very much. I would like to ask that my statement be inserted.¹

¹ See p. 106.

Chairman GLENN. Without objection, it will be included in its entirety.

Senator NICKLES. I would add just a few remarks to those made by my distinguished colleagues. I wish to compliment both Senator Ford and Senator Roth for their leadership and vision. I think it is very important that we do reform the budget process.

After serving eight years as a Senator—I now serve on both the Budget Committee and on the Appropriations Committee—I think the budget process is broken. It has not worked in the past and it needs to be changed. However, I happen to believe that this biennial review two-year budget process would be a giant step in the right direction. The budget process, as I said, is broken.

For the last two years we have had all appropriations bills thrown into one large package called a continuing resolution. The bills have taken more time to enact and pass than what was allowed. We send the approved bills to the President. The last one was approximately \$600 billion large and told the President to sign it all or veto it all.

I think that is evidence alone, and certainly enough, that the budget process is broken and needs to be changed. I believe the biennial budget would be a giant step in the right direction. This year, I am hopeful and optimistic that we will pass appropriations bills on time.

I would assume that all of my colleagues, whether they be on the Democratic side or Republican side, conservative side or liberal side, would agree with me on the following points. We should pass appropriations bills individually and on time, and have those be signed or vetoed by the President, with enough time for us to consider such changes as necessary.

We have not done this for several years. We need to do it this year. I believe we will do it largely in response to the fact that we had a two-year budget summit agreement, albeit. It was late and it left a lot to be desired. But this year, for the first time in about three or four years, we will actually be passing appropriations bills on time. This is a big step in the right direction.

As a member of the Appropriations Committee, every year we vote on the same items and amendments. It is not really necessary. With one Congress, we can pass two-year appropriation bills and then if needed make decisions. Whether it be on the MX, Midget Man, Big Eye, or whether it be on a multitude of issues, I do not really see anything to be enhanced by us debating those same, exact amendments. We should have yearly alteration between the budget bill and appropriation bill.

We end up voting four times when the outcome is already known beforehand. The membership has not changed. I doubt that philosophies have changed either. In most cases, we do not see the outcome or results of those votes change. I think it would certainly save the Senate's and Congress' time if we would vote one time and put those issues to rest.

I wish to compliment Senator Domenici for his leadership and his work, both as Chairman and Ranking Member of the Budget Committee. He has proposed on numerous occasions budget reform, biennial budgeting being one of these proposals. Mr. Chairman, it is my thought that this is just one step of several that we can and

should make to reform this process. It would be a big step in the right direction.

I am happy to join as a co-sponsor and hope that we will be successful in enacting this type of reform this year. As Senator Ford mentioned, this would allow us to take advantage of the changes in Congress and in the Administration this election cycle.

Thank you very much.

Chairman GLENN. Thank you very much.

Senator Domenici.

**TESTIMONY OF HON. PETE V. DOMENICI, U.S. SENATOR FROM
THE STATE OF NEW MEXICO**

Senator DOMENICI. Thank you very much, Mr. Chairman. I have a prepared statement that I would like you to make a part of the record.¹

Chairman GLENN. Without objection, it will be included.

Senator DOMENICI. There is a long list, I might say, of complaints about the budget process and there is probably some truth in most of them. And yet, I believe that the process put in place by the Congressional Budget and Impoundment Control Act of 1974 is fundamentally sound. With all due respect to those who are suggesting that we embark on some major restructuring of the Senate, in fact, I would argue that combining authorizations and appropriations into individual committees would loosen, not strengthen, the budget process.

Aside from that substantive concern, I am sure that the Chairman and members of the Committee are fully aware that we have tried restructuring Committees on a number of occasions here in the Senate and in the House and, normally, you cannot get it done. I think you all are aware of that. We tried reforming the committees three times in my span in the Senate and we end up maybe removing one committee and adding three subcommittees and by the time we are finished, it has hardly been worth our effort.

And do not forget that we have both bodies, not just one. If we go through reform and the other body does not, we have not accomplished much.

Before offering my own recommendations, let me emphasize one point. We do not have a deficit, in this Senator's opinion, because of the processes—either the budget process, the appropriation process or the authorizing process. In fact, had it not been for the 1974 Act, which is the Budget and Impoundment Act, I believe we would be in worse shape, deficit-wise, than we are today.

Instead of a major overhaul, I would pursue a more modest agenda with three major goals in mind—reducing the load, simplifying the process, and improving enforcement. My first two specific proposals are (1) adopt a biennial budget and (2) simplify the budget resolution to include only broad allocations, making these allocations binding.

Mr. Chairman and members of the Committee, let me give you an example of what I mean by my second point. As you and your staff well know, this year, because of the economic summit confer-

¹ See p. 107.

ence and the omnibus reconciliation bill that was adopted pursuant to it, we have, for the first time since we have had a Budget Act, three categories of funding and each is binding.

We had defense and we argued it out and once we set the number, it was binding on the appropriators. We had a function for foreign assistance and we bound ourselves to it and we had a function for all the remainder, called domestic discretionary. Frankly, that has had an enormous impact on restraining spending overall and forcing us to make some choices.

Third, I would recommend that we find some way to enforce more than just the first year totals in a budget resolution. Fourth, strengthen controls over new entitlements and mandatory spending. And fifth, change Gramm-Rudman-Hollings to better integrate it into the ongoing Congressional budget process. Find a way to enforce those binding targets earlier in the year, rather than later in the year.

Now, I could go into detail on all of these and I have done so in my prepared remarks, which I asked you and you graciously made a part of the record. But I would submit to you that there is one additional concept that fits into these recommendations that I truly believe is worth considering. That is that we think of adopting a budget resolution of the type I am recommending; simpler in form; not so many categories—maybe four or five; make the total absolutely binding on the appropriators', once you have debated; find a way to enforce the budget in the out years; and find a way to control entitlements.

You might say or your staff might find that out year entitlements have some limitation on them now. But it is only because of a very arcane provision in the Budget Act that we have any control over out year entitlements and that is a very simple proposition that you cannot have provide new entitlement authority in the out years if you do not have a budget resolution. But all we do to get around it now is change a few words and change an entitlement into an appropriated account. Then we have no restriction and it is such a mandatory appropriated item that it is just the same as an entitlement.

But the one thing I think we might consider is to make the budget resolution, Mr. Chairman, a joint endeavor—create a joint committee of the House and Senate instead of a committee in each body. Make it a joint leadership committee. Let it meet once every two years for the first 90 days of the two years and let that joint leadership committee iron out the totals. Then make them binding in the manner that I have just discussed.

Thus, you would come out of both bodies with the same fiscal game plan. You would never have a conference, unless one body or another to failed to agree by a vote. I think if you started with the concept of that type, it would truly be a Congressional budget and the priorities could be set the first part of two years in a joint manner. We could still have chairmen of that process. They would not have to be part of the leadership. They could be the chairmen of the budget process. But I think that is something worth considering.

I have discussed it only two or three times. I have never discussed the idea with House leadership, but have raised it before

the Bielsonson task force on the budget process. Along with these other approaches that I have discussed, I think it is worth some consideration.

Thank you very much. I would be pleased to answer any questions you might have.

Chairman GLENN. Thank you very much.

The Committee has before it now some 19 different budget proposals. It is quite a lengthy list here and some of them deal with the same parts of the budget process, some deal with different lengths—biennial budgeting which we are taking up today in particular.

In trying to make some sense out of this, we asked the Congressional Research Service and the Congressional Budget Office to comment on some of those and we put these together in a little booklet, "Proposed Budget Reforms, A Critical Analysis," just so we would have some organization of these materials so we would look at it, as some other people are looking at it, to decide what was needed.

We distributed that to the offices and I had each one of you given a copy of that as well. We also put some on the press table. If there are not enough back there, we can get more of them.

This was just a start at trying to organize some of this material so that we approach this in the right direction. Let me ask a question. Did you consider doing the authorizing and appropriating in the same year and the oversight in the alternate year? Was that one of the options you considered, Senator Roth, Senator Ford?

Senator ROTH. Basically, that is what our proposal provides. We have both the resolution and the appropriations in the first year. The second year we would leave free for oversight.

Chairman GLENN. I thought the way it was, was you had appropriations the first year and did your authorizing the second year. I just was wondering whether you had considered doing both those in the same year and then using the off year completely for oversight?

Senator ROTH. You are correct on authorization. Authorization and oversight are for the second year. You are absolutely correct.

Chairman GLENN. Did you consider the other options?

Senator FORD. Mr. Chairman, to implement the bill, to get it started in the first year, we had to have both of them combined so that we could start a two-year budget on October 1, 1989. You would pass the budget then for FY 90-91 that year, and we would be putting together the authorization and oversight at the same time.

Let me make a point, if I can, here. What we are attempting to do is give the Congress a management tool, a tool whereby we can set the budget, then have some time for oversight, to study, to look at programs and not be rushed. The second part of that, Mr. Chairman, is that you give some stability to your cities and your counties and your States as it relates to Federal programs.

I believe very sincerely that you could have the same amount of money each of the two years with a community or a county or a State knowing that that money will be coming. They can plan well and they will be able to get more cents from the dollar than under

the present procedure. They are not sure whether it is going to be x billions of dollars or x millions of dollars.

We try a three-day continuing resolution or a week continuing resolution and then, all of a sudden, we throw it all together and have an annual continuing resolution. As Governor, we were able to plan, say, in a program where monies would be available the first and second year. You could almost use that as a letter of credit, knowing full well that the money the State would appropriate and budget for the first year and there is an amount in the budget for the second year—you can use that, knowing that that money will be there.

So, it allows planning—it gives us some time where we can use the abilities that we have to bring to bear on the problems that we face. I think all of us—when you begin to look through all the recommendations, the two-year process is, I think, almost universal. Now, the ingredients within the two-year process are somewhat argumentative—if I can use that term—or we have different views. But the two-year budget cycle is, I think—the President, the Chamber of Commerce support it, Dr. Alice Rivlin testified the other day in support, and you begin to look at all of the people looking at the way we operate—the two-year budget process is very, very important.

Senator ROTH. I would just add one thought, Mr. Chairman, with respect to the authorization. It seems to me that it makes good sense to have authorizations in the second year because many people will be concerned in the other year with the budget process, either through the Budget Committee itself, the Appropriations Committee or the Finance Committee. So, from the standpoint of division of work, I think it makes good sense to have the authorizations the second year.

Chairman GLENN. Just one other question and then I will pass it along here. Did you consider breaking down the functions of Government by those that are more variable? Some functions of Government are reasonably stable and they would be very easy to predict over a two-year period. Others are more cyclical or more erratic in nature. They go up and down quite a bit.

Did you consider a two-year cycle for part of the functions of Government or did you consider that if we are going this route, we ought to go Government-wide and that is it?

Senator FORD. Mr. Chairman, in discussing with those who have handled the budget process—OMB, CBO, economists—the two-year proposal across the board seemed the way to go. The estimates are just as fair and just as even as what we are doing now and the estimates will come just as close as any that we are having today. So, we took it on a Government-wide basis.

Chairman GLENN. Senator Sasser.

Senator SASSER. Thank you very much, Mr. Chairman. I judge that there is strong sentiment for a biennial budget and, as I understand it, this would call for multiyear authorizations and appropriations. Is that what you are saying, Senator Roth and Senator Ford, that you have authorizing and appropriating in the second year of the process?

Senator ROTH. Appropriations would be in the first year, but we do propose a two-year resolution, a two-year appropriation and au-

thorization as well. I think the great merit of that is, it will cut in half the amount of work for the Congress and as several of us have already said, one of the real problems is that we are continuously voting on the same matter time and again.

It is confusing, I think, to members of the Congress, but it is also confusing to the public at large. I remember one summer we came home, having passed a certain resolution and voting on that. We came home a little later in September and people said, I don't understand this. I thought you had already voted on this matter and it has been decided. It is very difficult for us, as Members of Congress, to follow this complex procedure.

But let me say, it is almost impossible for those at home, for the members of the State and local government to follow our procedures and have any idea as to what is happening. I think that in itself is not only bad management, but wasteful of funds. One of the real benefits of what we are proposing here through the two-year cycle is that it enables the people back home to begin better planning. I think that that is something we should keep in mind.

Senator SASSER. I think Senator Ford's statement made a lot of sense, talking about State and local governments being able to plan better and I get the same input, for example, from defense contractors who indicate that if they had a better view of what might be coming the following year, then they might be in a position to give the Government better prices.

Senator FORD. Senator, may I say, that is one reason that Senator Nunn and Senator Warner have gone to the two-year budget process in Armed Services, as your distinguished Chairman would know here, and they found that to be very, very valuable and it points up just exactly what we are trying to do here this morning.

Chairman GLENN. About 60 percent of the stuff was not repetitive in the second year on Armed Services what we found. We were considering about 40 percent of the things that we would consider normally in the first year in which we did that, which was this past year.

Senator SASSER. Let me ask—Senator Domenici is sitting there and he is a battle-scarred veteran of the budget process—probably has more scar tissue fighting these budget battles than anybody in the Congress.

The General Accounting Office estimates 60 percent of all votes in 1980 through 1985 were budget related. Now, it appeared to me, just as a member of the Budget Committee from 1977 through the present time, that the process appeared to work reasonably well until we got to 1981, January of 1981, and we got an Administration that appeared to be at logger heads with the Congress, over a period of a number of years—whether this body was controlled by the party of the Administration or the party opposed to the Administration.

I am just wondering—and I would like to ask you this question, Senator Domenici—how much of our problem is caused by the process itself and how much is caused by the inability of Congress and the Administration to cooperate in a meaningful way on trying to resolve some of the budget dilemmas? It appeared to me that we were really trying to use the process, on occasion, to frustrate the

purpose of coming up with a budget. I know you were in the forefront of those battles and that is the reason I ask you the question.

Senator DOMENICI. First of all, Senator and Mr. Chairman, I am not sure when you cite the survey as to the percentage of votes that are budget related—I am not sure whether that means budget process related or budget related. I would assume it probably means budget process and appropriations.

Senator SASSER. I would assume, but I do not know myself, frankly.

Senator DOMENICI. We are almost always confusing the budget process—that is, voting of a budget resolution or whatever is going to implement it—and the appropriations process, as you well know. That is generally referred to as the budget process. But in any event, I do not think there is necessarily any relationship between the percentage of votes that occurred that are budget related and this Administration versus this Congress.

I think it is more that when you have major fiscal problems, obviously, you are going to be required to do more difficult things. When you have to do more difficult things, with reference to expenditures and the like, you have to take more votes.

If it is going to be a very simple and non-confrontational budget resolution or if the difference of opinion is a billion dollars, as compared with 30 billion dollars you are going to have fewer votes. But if the differences between the two houses or between the President and one of the houses are larger, then obviously, it becomes a more difficult issue.

In summary, I think the budget, appropriations, and continuing resolution process has become more front and center because the deficit has been more of a front and center issue and a more difficult one. I do not know how you are going to make that easier so long as you are going to be required to make difficult votes.

We have added another layer with the Gramm-Rudman-Hollings. That takes some additional votes. We have points of order that have been added to this process through Gramm-Rudman-Hollings and that takes additional votes. All of those are counted in that. But frankly, I do not think the percentage of votes is terribly relevant to whether the process is working or not.

Let me address another question that has been asked about the two-year authorization and when you ought to do it. Frankly, I think authorizations will fall into place—single year, two-year or multi-year—once you have decided what process you are going to use for budgeting and whether you are going to have two-year binding budgets.

If you are going to have two-year binding budgets as a minimal, I think maybe the totals in the budget resolution ought to be binding for three years. But even if you had two-year binding budgets, the authorizers would feel much more comfortable doing their work within the limits of that budget than we do now, since it changes every year.

If we are going with a two-year budget resolution, might I suggest to you—and to the two principal sponsors—that one of the problems you are going to run into is economic assumptions. You argue about economic assumptions for the first year and do not forget that at that point, you are making them more than one year

ahead of time. If you are doing a two-year budget, you are literally in the second year making economic assumptions three years ahead of time.

Senator SASSER. We are never very accurate on the one year assumptions.

Senator DOMENICI. And nobody is very accurate on the one year assumption. Now, that does not mean that economic assumptions are foolhardy. They are just not science anymore. Nobody can predict the international market and our markets very accurately. It is more like a religion, Mr. Chairman, than a science—at least, forecasting is.

But in any event, if you are going to go two years, then you are going to have to make some allowance for one of two things. If the economic assumptions cause the deficit to be greater than you had assumed, then you have to decide that you are going to have some kind of automatic reductions. Or you are going to have to say, so long as the programs do not change, if it is just the economic assumptions that caused the changes, you are going to have to have some forgiveness provision in the second year.

Senator FORD. Mr. Chairman, might I inject here with my good friend. Under the Gramm-Rudman-Hollings, you already have a trigger and we have not changed that in our procedure. So, if your economic assumptions are up or down, based on that assumption annually within the two year budget, then the Gramm-Rudman-Hollings would trigger. So we basically have not changed that in this piece of legislation that we will introduce this afternoon.

So, yes, we are going out in the out years, three years out. Right now, we authorize three to five years and our assumptions are no better today than they were last year or will be next year. But under this process, you at least have a period of time where you can have oversight, you can look at programs, and you can do a better job because you will have the time and you will not be passing a budget in an election year under these terms. It will be passed in the first year of the Congress.

I think there are a lot of pluses and minuses, but I certainly believe, as Dr. Rivlin said the other day, that the pluses far outweigh the minuses.

Senator DOMENICI. I do not disagree. I was merely saying that if you wanted to build Gramm-Rudman-Hollings into your two-year budget—

Senator FORD. It is in there.

Senator DOMENICI [continuing]. And you want to move it up front so you are not delaying everything, then you have the problem adjusting the economic assumptions. I would rather see Gramm-Rudman-Hollings moved up front in the cycle instead of waiting until the tail end.

Senator SASSER. Mr. Chairman, I must say that I agree with our distinguished colleague from Kentucky, but I think we are all aware, I believe, that the budget process needs some overhauling, but I think we also ought to be aware of the fact that simply changing the process to some extent is not going to solve what I perceive to be the overriding problem of the last few years and that is, an Administration and a Congress that have been at logger heads, taking diametrically opposed views as to what is to be done

about budgetary matters, where the priorities are to be placed, and taking opposite views about what is to be done about the deficit.

Changing the process, I think, can be of some aid, but it is not going to solve what I perceive to be a fundamental, underlying problem that has plagued us for the last several years.

Chairman GLENN. Senator Pryor.

Senator PRYOR. Mr. Chairman, I did not really come here today to make a statement, and I had not really planned to ask questions. I am fascinated with this process that we have, and I am also fascinated with the dilemma in which the Senate and the House find itself in dealing with our budget.

I would like to say first, Mr. Chairman, I thank you for holding this hearing; and, secondly, I think we owe a great debt of gratitude to the four Senators who have appeared before the Committee this morning.

I just have a fundamental question; and if I could, I would like to address this question to my friend from New Mexico, because he has been the Chairman of the Budget Committee and, I assume, was in the Senate in 1974 when the new budget process was set up. My belief is this, and I am going to ask you if you agree or disagree. I think that we made an attempt in 1974 to streamline the process. I know what the intent was. I know what the Congress intended to do. I think I know, at that time, what some of the problems were.

My question is this. One, what was wrong with the old system? It served this country pretty well almost 200 years: the authorization process and then an appropriation process. It dealt with more, I think, a degree of finality. You talked about redundancy—the Senator from Delaware has—and that, I think, is one of the problems of the Budget Act of 1974 and what has resulted from it.

One, did we make a mistake in 1974 in adopting the Act and two, are we making an additional and maybe even a greater mistake by trying to patch up a system, which most of us think has broken down?

Senator DOMENICI. First of all, you were asking me this question, I assume. I don't want to impose on Senator Roth if you were asking him.

Senator PRYOR. Well, I know that you have been Chairman of the Budget Committee; you did a splendid job and I am calling upon your expertise.

Senator DOMENICI. Well, let me tell you just quickly—when I arrived in the United States Senate, I believe there were 17 new Senators. We voted on appropriations bills. None of us were on Appropriations. That committee was pretty heavily-laden with seniority then.

I think we voted on about four or five bills and we asked the simple question, what are we voting on? With reference to what totals are we voting? When will we know what the total budget of the United States will be? We were told, wait around, young men. By the time the end of the year comes, if you have got some calculators and if we have done our arithmetic right, we will add it up for you and we will tell you.

We said, are you kidding? I mean, nobody does business that way. Well, the Congress had been in the business of trying to set a

kind of an overall game plan, or blueprint, which they were starting to call the budget process.

All the new Senators signed a letter to the leadership saying, we are not going to vote on appropriations. We are all going to vote no unless we have some assurance that we have a game plan in advance against which those appropriation bills are being measured. Each one sounds great, but we do not know at the end of the year what we have really voted on because the Executive budget is not binding and we do not have any budget.

So, essentially, the answer to your question is that the budget process was an effort to put into place a response to that kind of situation. If anyone thought it was streamlining, they were mistaken because we refused to streamline when we adopted that budget process. We did not get rid of any of the processes that existed.

We built a third one on top of them. Appropriations remained intact. As a matter of fact, until this economic summit conference, you must understand that they had absolute authority to move money around from any function, bound only by budget authority totals at the end of the year. We built in outlays later and this year, we built in three functions. When you vote on those three functions, you know that they are going to be bound by those three totals.

So, it was not a streamlining. It was an effort to set an overall blueprint on top of these two previously existing processes. And it worked very casually for awhile. Then, when the real confrontation occurred with a new President, who wanted to dramatically change priorities, the budget process was called upon to do a bit of heavier lifting than was contemplated when it was put into existence. Reconciliation was called upon by choice as a *modus operandi* for forcing committees to make dramatic changes in programs.

In addition, we had a confrontation over impoundments that you all are aware of that had gone to the United States Supreme Court that needed rectifying. So, the budget process should not be misunderstood. It was also an impoundment and rescission issue at that point.

The budget process needs reforming. No question about it. But I think you absolutely need a binding blueprint of some type, multiyear in nature, against which the other committees of Congress must work. Otherwise you have little chance of restraining the automatic growth of Government and the automatic appetite of a national Government, which has no limitation, other than economic ruin or politics. There is no other limitation on its spending. So, we need something.

Senator PRYOR. If I might ask my friend from New Mexico, why could we not do this at the authorizing level, mandating where those expenditures either could come from and prohibiting where they could not come—why could we not do that at the authorization level, which would ultimately give us more time when we get to the appropriations bills to see what priorities this country really needs.

My theory is, Mr. Chairman, once we go through all the budget resolution, the reconciliation and all this business, by the time, in the Senate at least—I do not know how the House does this—when we get to the appropriations bills in the Senate, it is Christmas and

the kids are out there in the station wagon, out there in front, and the mother-in-law is calling and when are we going to get there.

Before you know it, we have that intense pressure on us to close this place down. We pass a continuing resolution, a CR. I refer to it as combined retreat. I think that is what the CR stands for. I wonder why we have to have this system, why we have complicated this system unnecessarily.

Well, that is what is wrong with it. [Laughter.]

Senator ROTH. Let me point out that in 1973, I think, Wilbur Mills in the House and I in the Senate, led a fight to put an overall ceiling on the budget for the reasons mentioned by Senator Domenici. There was concern that you did not have any idea how much spending was going to be done because you had to wait up to the end of the year. The thought was that the Government, much like the private sector, should decide overall budget limits.

Now, we got our debt ceiling through in both the House and Senate, but unfortunately, in the Senate, on impoundment, under our proposal, we gave the President the authority to impound to meet those requirements. One of my Republican colleagues did not like that and put a soft control on it and we were never able to agree with the House, which would have given the President that authority.

As a result, the Joint Budget Resolution was created and the principal thought at the time was that we wanted an overall limit, that you did not have it under the old system. I might say also, Senator Pryor, that it is my understanding that we did not have the same system for 200 years. There was a time when your authorization and budget and even your revenue were controlled by the same committee, but they constantly changed it as they created new problems.

But the thing that I think is important to understand is that the Budget Committee, I think, went far more into detail than ever anticipated. I think what Senator Domenici is talking about is moving back to more of the original intent to set overall limits, but not duplicate.

If I might, just in closing—I know we have another distinguished Senator who has been a leader in this area of reform—Senator Ford and I do feel very strongly that the time has come to act on the two-year. There may be other things that need to be done, but at least we have a very broad consensus on this, both in the House and Senate and we should take what action we can. I thank you, Mr. Chairman.

Senator PRYOR. Thank you.

Chairman GLENN. Thank you very much and I know we are a little bit afield from our biennial business, but I wanted to let this go a little while here because it shows the complexity of this and it shows what we are up against in trying to create budget reform, whether it is biennial or whatever it is.

I arrived here in the Senate, was sworn in, and the first Democratic caucus that I went to was the beginning of the Congress when this went into effect, the beginning of 1975. I remember that Democratic caucus that day better than any caucus we have had since then because Senator Muskie, who was the proponent in this Committee—the father of the Congressional Budget Act, I think

you could really say—got into a discussion, in our Democratic caucus, with Senator McClellan, who thought it was going to be the ruination of the United States if we went to this new system.

Of course, he was head of the Appropriations Committee at that time so he had his own view of this thing. I will tell you, when these—I guess you could call them two old bulls of the Senate—went at each other and I was not sure I wanted to stick around this place when they got done. They really went at it as to what the pros and cons of this whole thing were going to be.

To make a short answer to your question awhile ago, what had happened at that time was the authorizing and appropriating process, the way it had been working was, no one knew what the bottom line was during the year. You did not know where you stood with the budget. It was the argument that was being made.

It was like—to go back to your family analogy again, Senator Pryor—it would be like you took that same family out to Safeway or out to the supermarket some place. You would turn them all loose in the supermarket to buy whatever they wanted to buy and then you are supposed to all get together at the end of the session and find out what it totalled up to at the supermarket.

That was what was happening at the end of the year here. Each Committee went its own way. The Appropriations Committee did its own thing. At the end of the year then, you finally came up with a total and nobody really knew what the total was, I gather. You were here for a couple of years in that old time period. Nobody really knew what the total was until the end of the year came and then they, oh, my goodness, what have we wrought here. This is a terrible thing. We have gone so far over.

So, they were going to put the Congressional Budget Act in as an oversight over this to monitor, in the Spring, put forward the big objectives. Here is basically what we can afford for defense, here is for agriculture, here is for something else, and put the objectives out there and then we lock it in solidly in the Fall. Meanwhile, that was to be the overall guide for authorizing and appropriating.

Now, what has happened is, instead of in the appropriating process—or in the authorizing process first, we see, in committee, the same amendments put in, the same amendments that are defeated maybe in committee, come up out on the Floor. We then see the appropriating process take up those same things in committee and out on the Floor.

Then the budget process, instead of addressing the big problems, the big directions of the country that it was supposed to do, and secondly, to give us a running total through the year—which, incidentally, we used to put on everybody's desk once every month or once every two weeks. We ought to get back to that, as a matter of fact.

Instead of doing it that way, we now find the budget process itself being used to do all those same things, the same old tired amendments that we saw in committee and out on the Floor three or four times before, are now in the budget process itself and what we have done is we have made legislative WPA. Make work is all it is and that is the reason that everybody is so disturbed and I am, too, and we are trying to take one little bite out of it here today.

It is the reason why the Committee asked to have some other people look at this and try and determine the analysis of the overall budget process and whether we need some bigger changes along with biennial budget or whatever we decide to do. So, I do not want to delay the hearings here. We have an awful long ways to go, but I just thought I would get that in.

Senator PRYOR. Mr. Chairman, if I might just add this little tidbit, talking about the legislative WPA—just for those who like trivia. We now have 174 staff members of the Budget Committees in the House and Senate. I do not know how that would compare to the Appropriations Committees. The Appropriations Committee, in that process, is mentioned in the Constitution. I do not think there is any reference to the Budget Committee, but we see where our priorities are going. I thought that might be of interest to you.

Chairman GLENN. It is indeed.

We have been joined by Senator Kassebaum. We are glad to have you join us this morning for any comments you want to make.

**TESTIMONY OF HON. NANCY LANDON KASSEBAUM, U.S. SENATOR
FROM THE STATE OF KANSAS ¹**

Senator KASSEBAUM. Thank you very much, Mr. Chairman. First, I would just like to say that I am very appreciative and pleased that you have called these hearings. I think it extremely important and I know that Senator Pryor, as well as yourself, has given a great deal of thought to the importance of some changes, perhaps, that we should look to here and I certainly feel that is true, too.

I think just as we change as an institution, we have to adapt to the different pressures that are put upon us or, I think, we run the risk of becoming irrelevant. I am a strong supporter of the bill that Senator Roth and Senator Ford will be introducing today, I believe, on the two-year budget cycle. I have been a member of the Budget Committee for ten years now and we have had some very fine people who served on that Budget Committee and Chairmen who have given extraordinary leadership.

I happen to believe, Mr. Chairman, that it is important for us to even go beyond the two-year cycle. I think that what we lack, I believe, in the Senate today is a process that helps us be more effective and more efficient. I would like to see the Budget Committee composed of the chairmen of all of the committees and ranking members. That way, you pull together, of course, the interests of your committee and you are going to be fighting for that, but it helps to lay out the priorities and, I think, we are better able to provide that leadership.

It strengthens the leadership of the committee chairmen and ranking members, which I think we need today to provide some structure and perhaps discipline. I think it would be important to combine the authorizing and appropriating process. Senator Inouye and I have introduced a bill that would go more into an extensive committee reform initiative.

Without going into that at this point, I would just like to say that I think that your efforts to hold these hearings—the Rules

¹ See p. 117 for Senator Kassebaum's prepared statement.

Committee has had a hearing as well—and out of this, I hope that we can work together to achieve some changes that will help us here to address the issues, rather than just reinventing the wheel.

Thank you, Mr. Chairman. If I may ask that a full statement be made a part of the record.

Chairman GLENN. Without objection, your entire statement will be included in the record.

Just one brief question here. Senator Stevens has brought up the possibility of combining authorizing and appropriating committees as a first step, and then go to biennial budgeting. Is that a rational way to go or do you think we should go ahead with biennial budgeting?

Senator KASSEBAUM. Well, I would like to do it all at once.

Chairman GLENN. You what?

Senator KASSEBAUM. I would like to do it all at once.

Chairman GLENN. You really want to mix it up, don't you?

Senator KASSEBAUM. And I suppose that—this is what we would have to stop and think about—how it meshes together and it seems to me, if you go to a two-year budget, it is important to think of also moving to a two-year appropriations cycle so that you have got some coordination between the two. His structuring of combining authorizing and appropriating would differ a bit from the approach I would take, but he is a member of the Appropriations Committee.

Nevertheless, I think that there are many people who are thinking along the same lines and that is why I hope, Mr. Chairman, out of these discussions, we can put together a consensus that will be a step forward. As you know, Congresses, through the years, have looked at reform. Senator Kefauver, when he was a member of the House, wrote a book on reform, following the LaFollet reforms in the 1940's, which is very interesting and his mentioning the overlapping work and so forth, which we could still speak to the same problems today.

But I think the pressures on us and the outside pressures on us, particularly, mean that if we are going to do our work as we would hope to do it, I think, we need to change the way we do it.

Chairman GLENN. Thank you.

Senator KASSEBAUM. Thank you, Mr. Chairman.

Chairman GLENN. Senator Roth.

Senator ROTH. Thank you very much. I appreciate the fact that you are co-sponsoring and I have been much interested in your other reforms. I guess one of my serious concerns is that it is so difficult to get a major reform through until there is a consensus and for that reason, it seems to me this year, we have a real possibility of at least getting the two-year cycle through because there have been any number of members of both sides—Democrat and Republican—in the House as well as here, who support the concept.

What worries me—and I think you have some excellent ideas in your legislation—is that it will be very difficult to get those accomplished this year.

Senator KASSEBAUM. I certainly agree, Senator Roth. That is why I am speaking on behalf of the bill that you and Senator Ford are introducing. I think it is probably wise to take what you can get

and this is perhaps a first step. But I do not think it should be done in lieu of the larger efforts and that I do believe is important.

All of us, about three in the morning, on December 23rd, when we are trying to finish the continuing resolution, say that we are not going to let another year go by without changing some of our procedures. And then we come back in February or January and we forget the frustrations of the moment and that is why I think, Mr. Chairman, that maybe some really very thoughtful work from here and the Rules Committee perhaps can help us address this problem.

Senator ROTH. One further question alluded to by Senator Pryor is that we have seen, of course, with the creation of the budget, you have the Congressional Budget Office and you also have the committee staffs for both the House and the Senate, as spelled out by Senator Pryor. Then, of course, you also have the Armed Services and the Appropriations Committee having their staffs.

Is there any way for consolidation or is this desirable? It does seem like—as our Chairman said—we have created a WPA of the Hill. Is there any way we could address those problems?

Senator KASSEBAUM. You mean staff?

Senator ROTH. Of these various committees.

Senator KASSEBAUM. Well, there has to be an integration of the committees. For instance, you mentioned Armed Services—under the legislation that Senator Inouye and I introduced, it would be an integration of the Appropriations Subcommittee with the Armed Services Authorizing Committee so that you have one committee, which would take a bill to the floor that would both authorize and appropriate and using a two-year cycle.

So that hopefully, one year, you are looking at the budget initiatives of the committee, both from the authorizing and appropriating standpoint, particularly appropriating. In the second year, hopefully using then the committee's time and focus of energies on oversight work. It would seem to me that this is a structure that would allow us to do both in a more efficient way.

Senator ROTH. My time is up. Thank you, Senator.

Senator KASSEBAUM. Well, you do have many experts here to testify, Mr. Chairman. Thank you.

Chairman GLENN. We have taken a long time. Let me ask just one additional question. Do you think we could do that—combining of authorizing and appropriating committees, one or two committees at a time to try it out? Could we do it with Armed Services and try it out and see how it works before we did it Senate-wide? Or would that just confuse the issue even more?

Senator KASSEBAUM. Well, you know how we are.

Chairman GLENN. Unfortunately, yes, I do.

Senator KASSEBAUM. I think it would confuse the issue and I am afraid if we do it to one committee and then all of a sudden, everybody else is going to try and protect their committees and then it just would not work. I think you almost have to decide that if you are going to use that type of approach in that significant a structural change—

Chairman GLENN. Well, we did two-year budgeting in Armed Services over the past couple of years and it has worked out fairly well.

Senator KASSEBAUM. Yes.

Chairman GLENN. Maybe not as well as we had hoped, but it has meant that about 60 percent of what we did was cut out this year. It allowed us to concentrate on some of it, a little bit more than we would have otherwise, and that did not work out badly. That was done just on that one committee.

Senator KASSEBAUM. I think we are seeing the two-year initiative. We have just done it, of course, with the budget to a certain extent, after the budget agreement. I think we all have come to recognize that that does provide a little more order to the process.

Chairman GLENN. Thank you. Thank you much.

Senator KASSEBAUM. Thank you, Mr. Chairman.

Chairman GLENN. Our next witness is the Honorable Charles Bowsher, Comptroller General, United States General Accounting Office.

Mr. Bowsher, we are sorry to have this delayed this long this morning before we get to you, but it has been an interesting morning here and I think the discussion has been rather informative and shows the concern at least that the members of the Senate that have testified here have on this. I think the time is ripe for some changes and so we welcome your expert testimony.

You have appeared before this Committee many times. We always find you very thoughtful and judicious in what you say and we appreciate you being here today.

TESTIMONY OF CHARLES A. BOWSHER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE

Mr. BOWSHER. Thank you very much, Mr. Chairman and members of the Committee. It is our pleasure to be here today to talk about this subject as we fully agree upon its importance and we think that it is awfully important to get the budget deficit itself down, and also to try to streamline the process.

I think that really would be one of my main messages here. By the way, I would like to summarize my statement,¹ Mr. Chairman.

Chairman GLENN. Without objection, the entire statement will be included in the record.

Mr. BOWSHER. And that is, I think when you look at the process today, it just has too many layers, too much process and forces too many votes on the elected officials. Although it is very understandable that in 1974, there was a desire to get an overall view of the budget, I think what Senator Domenici said earlier that they put the Congressional budget process on top of the existing processes is correct. That was the beginning of some of the problems when you failed to strip out some of the existing processes.

And then when you added Gramm-Rudman you put another process on top of that. So I think that one of my big urgings to the Congress on this subject would be, whatever you do, to keep in mind "streamlining and simplification" as two bywords as to what is really needed to make the process workable and intelligible to the members and to the taxpayers and the people out there.

¹ See p. 121.

I also think, one of the great unfortunate byproducts of the present process is what many of the witnesses previously said and that is, it is very difficult for people to plan. It is difficult for State and local government to plan; and it is difficult for the Defense Department to plan for their weapon systems. So I think that whatever can be done to assist those people in understanding our Federal budget process and to be able to plan better at their level would be a real plus.

On the biennial budgeting option itself, I think that it has a certain attractiveness. We have supported it since the early 1980's. We have always kind of advised that it be tried on a selective basis before we implement it Government-wide. That was always our advice and we were pleased when the Armed Services Committee did try it with the Defense Department.

We were somewhat disappointed when Secretary Weinberger insisted on sending the second year over to you unconstrained and I think therefore, we did not get as good a test of the two-year budget in the defense arena as we should have got. But I think it is still well worth using it in that area.

The other thing I think we should point out today is the results of a report that we issued to the Congress sometime back in which we studied the State governments budgeting practices. We found that 31 of the States today do have annual budgets and 19 have biennial and of the 19, only seven meet every two years so they have no choice but to have biennial budgets. On the States that have changed in recent years, 12 went back to annual and three went to biennial. So you can see a mixture here of how some people do view the biennial concept.

Chairman GLENN. Just a minute, before you go on, is there enough difference in operation in a State government and the Federal Government, that we should not be comparing those two and whether they are moving to or from biennial budgeting?

Mr. BOWSHER. I think it is worth looking at. I do not say that it is so similar that you would do one because the other one was doing it. I think the Federal Government has some uniqueness to it that should be considered. That was one reason why we also always thought that some of the longer term appropriations and authorization bills, like defense procurement systems, lent themselves a lot more to biennial budgeting than say the operating appropriations and operating accounts in the various things.

Senator ROTH. Could I ask one question there, Mr. Bowsher? Is one of the reasons that the States moved towards a one year because of the Federal budget?

Mr. BOWSHER. I think that is a factor. I think that one of the things they have tried to do is to try to stay in sync with the Federal system and I think that has been a factor. I think it was also one of the reasons they found the change of the fiscal year, some years back, very difficult. If you remember, we did that because we thought we would get away from continuing resolutions and solve our problems. I think that put a big burden on the State and local governments.

If I could also just mention for a few moments here importance of the numbers themselves. I think we are suffering from a budget process that has lots of numbers that most people do not under-

stand. When we get them from the OMB, it is very difficult to understand that document. I think that we need to modernize the format of the budget. We should make it simpler. I think we should keep the unified feature of the budget, but should consider some capital budgeting and certainly on the trust funds, I think we should show them separately.

In our prepared text today, we present a four-part budget format that would separate operating from capital and trust funds from Federal funds and I think those are the kind of things that should be considered. I also think the other improvements that your Committee has looked at and legislation that your Committee has considered in the financial management area as to actually how we spend the money and how it is tied back to the budget deserves consideration at some point in time.

I think we could do it in a much simpler way than it is today so that everybody is looking at the same numbers. I think one of your great problems in budgeting today is, everybody is working with different numbers at most of the meetings and you lose an awful lot of time debating which are right.

So, I think the budget format and the simplification of the process, of which biennial budgeting would be one feature, is worth looking at, but I would also certainly try to reduce the layers of process that we have, as you move forward with these changes.

Chairman GLENN. Thank you very much.

You are so right in the statistics we get and the data that we get, which is confusing. We get some figures from the Administration; some figures from the CBO; some figures from you.

Mr. BOWSHER. That is right.

Chairman GLENN. And they all differ tremendously on what political push the particular group has and so we wind up with being reminded of, I guess, that old figures do not law, but liars figure. That is what we run up against here. Then we try to combine them all, take an average and sort out where we go from there and that is a lousy way to run a government.

Mr. BOWSHER. You know, Australia is moving to a budgeting system where they actually have—are going to have terminals in each member of Parliament's office. You are going to have the same information that the Ministry of Finance has, where they do the budget, and the same information back in the different ministries. I think we should be moving towards that in the Federal Government here.

Chairman GLENN. I am not quite sure we want that.

Mr. BOWSHER. That is right. A lot of people do not want to move to that because they do not want to give up what they consider power when they control the numbers. But I think it is just tearing the process apart myself, as we work with all these different sets of numbers.

Chairman GLENN. Your proposal for segmenting the budget into operations versus capital and trust fund versus non-trust fund—we have a whole bunch of proposals. Do you think that has to be done before we go to something like biennial budgeting or combine an authorizing and appropriating processes? What is the preferable order of reform?

Mr. BOWSHER. I guess in my preference, I would do it all at one time, but I also understand what Senator Roth said a minute ago and that is, sometimes you get a consensus for some of the reform and not the other and you have got to move with what you can get. But I think that right now, the budget format does not show the true financial position of our Federal Government.

I think the trust fund surpluses that we are running are financing the general Government operations. A lot of people have a very hard time understanding that from the way the current budget is presented. So I think that needs to be changed at some point and I think also, we are running into some severe problems here on the capital issues and decisions in our Government.

I think you have great pressure now to take the Post Office off budget. You are going to have great pressure to take the highway and the airport trust funds off budget because everybody that has got a capital intensive operation or needs to invest in capital items to bring down their labor costs are going to want to get out from under the current budget process, which treats every dollar as an equal dollar.

So I think that at some point, we have got to look at this capital versus operating question and I would do it in a manner that I did not lose my unified budget concept either. I think you can do both. And that is what we have tried to illustrate here.

Chairman GLENN. You would keep all the trust funds in then or out?

Mr. BOWSHER. I would have the trust funds as a separate column and show it in the total, but I would show it as a separate column.

Chairman GLENN. But keep it as part of the unified budget?

Mr. BOWSHER. Yes. I would have a unified budget column, but then I would keep the trust funds out here and show it as a separate grouping so that everybody fully understood what the revenues and the expenses of the trust funds were versus the rest of the Government.

Chairman GLENN. Okay. But I think that if you keep it as part of the unified budget—I am not here to debate that particular point—but I think if you keep it as part of the unified budget, you run into what we have run into with the airway trust fund, the highway trust fund and so on. As long as it is part of the unified budget, even though the money is collected for a specific purpose, the Administration will not spend it because it will show a bigger deficit on the bottom line.

Mr. BOWSHER. Unless you change your targets. In other words, what you could do, once you get the proper format is, you could start setting up targets that you want to achieve for the major components of your budget, rather than that one unified total at the end.

Chairman GLENN. Okay. But we have had a problem with this with the airway trust fund. I have gone over that with Don Ingram and so on. They would not release it out of Department of Transportation. FAA could not get the money to do the things that had to be done. We all cry about air safety. We all are very concerned about it—near misses and so on, yet the Administration will not release money enough to upgrade the airway system and we have almost \$6 billion sitting there right now.

Mr. BOWSER. If you have any Administration that insists on doing that, you would have that problem no matter how you format it. There is no question. But what we are saying is, if you get a better format of your budget, it seems to me that Congress and the next Administration could possibly work out targets, including if they want to maintain the Gramm-Rudman process, more on the major components of the budget, rather than just that one unified total.

I think that is what drives you to those problems, just as you described, Mr. Chairman. As long as you work on that one total, you are going to have a tough decision here and that is, do you see the operations go downhill, as far as effectiveness and efficiency, or do you put the emphasis on that one overall budget total.

Chairman GLENN. In some ways, you can look at as almost a swindle on the taxpayers because they are being taxed—let me take the airway thing—eight percent on every airline ticket right now. The purpose of it, as passed in law, was to provide a fund to upgrade the airway system, keep it modern, provide oversight of maintenance and pilot inspections and all these things and that was the purpose of it.

People said, okay. People accept that. It is an eight percent tax, but that is in the interest of safety and so on. And then we get it in there, they are still paying it in, but because it is part of the unified budget now, we will not take anything out because it is going to show a bigger deficit for this Administration. So, they have been very tight on money to upgrade these things.

Same way in the highway trust fund. I started out as the biggest proponent of a unified budget so the people would know every tax thing, it is all combined, there is nothing hidden. The problem is, it is all out there now and the Administration will not spend it to do the things it is being collected to do. And so, I have a great big question mark in my own mind right now as to whether we should not take some of these things off the budget now so that they can get used for what they were supposed to be used for.

Mr. BOWSER. Well, I would hope that we could keep most of the Government on budget and get to more and different targets and do it that way, rather than letting everything go off budget and getting rid of everything.

Chairman GLENN. We have had a long interest in financial management reform and I know of your interest in that also. OMB created a CFO last year and promised that by the end of the Administration, the CFO would be a household name. I gather you have completed your review for the Committee on how the CFO is doing. Can you summarize that very briefly?

Mr. BOWSER. Yes. We think the CFO has tried to do a good job, but I think as you said in your opening remarks, Mr. Chairman, we have not seen the products delivered on time as they had promised. I think also, you go back to two or three real problems which we highlighted at the time. That is, you have sustainability. In other words, are we going to have a CFO and resources concentrating on these kind of programs over a period of time or because of lack of resources over there at OMB, the job is not going to get done.

The second thing is, we really worry about the emphasis that budget has versus management. We just have not seen, in any Ad-

ministration, Democratic or Republican, where the management side of the house really gets the job done, you might say, and that is why we wonder if the CFO should not be over in Treasury or in some separate office, rather than in that OMB position.

Chairman GLENN. My time is up. Senator Roth.

Senator ROTH. Going back to this question about off budget, one of my concerns is that we are really looking at procedures and whether they are off budget or on budget, I do not think really is the problem. The real problem is, we do not have the will to make the decisions if we are truly interested in balancing the budget over the long term.

If we take them off budget and spend the funds in these various trust funds, then if you are going to meet Gramm-Rudman and you have got a lot of things already set aside, it seems to me you are going to have similar complaints about holding down discretionary in other areas. It seems to me the nub of the problem is trying to reduce the deficit and, of course, we like to do it in the least controversial way.

Mr. BOWSHER. I think that is right. The big problem we have facing us is reducing that overall deficit and I think one of the problems with Gramm-Rudman was, it set up certain targets and excluded a lot of different programs. I think the more you exclude, the more you compound that problem.

But at the same time, I do have sympathy for the people that have to run those programs, whether it be the airports or the highways or the Post Office, and that is, they have got to have a proper stream of funds, especially in the capital area, to make the investments that can make them an efficient operation. If Gramm-Rudman targets or OMB policy on the unified targets keeps that from happening, then you run into some very serious operating problems.

I think one of the ones we have got today is in this S&L and banking area where we cut back on a lot of the bank examiners and supervisors and so we are going to pay a very dear price for that and that was done, to great extent, because of budgetary totals that people were trying to meet. So I think, when we force ourselves sometimes into some of these rigid systems, we really do a lot of damage to Government operations.

Senator ROTH. Addressing again this question of a deficit, it seems to me that part of the problem is divided Government. There are genuine differences between the Executive Branch and the Congress because they are in the hands of different political parties.

Is there anything, procedure-wise—now the so-called leadership package has sort of expedited the procedure this year—but is there anything we should learn from that process that might help?

Mr. BOWSHER. Yes. I think the main thing to learn out of that is, if you can get overall agreement by the leadership at the beginning of the year or for a two-year period, that can be very helpful. I think if you could then get the rest of the budget process down to one set of votes and committees on the different components of your Government operations, then you would have a simplified budget process that people could understand and I think you could get through it in the time frames.

So, I think you do need that overall leadership agreement at the beginning and I think the White House has to be involved if it is going to be effective. I think you would be much better off if you could get it down to one set of committees and move it forward on that basis.

Senator ROTH. Would it be better if the Budget Committees were made up of leadership?

Mr. BOWSHER. I think so.

Senator ROTH. I do not think there is any question. I think the problem in the past is that many times they have been made up of younger members of the House or Senate, very able, but they do not have the political punch or background.

Mr. BOWSHER. What you have got now is four very detailed processes. You start with that budget process with the Budget Committees and you have authorizing and you have appropriating and then you have Gramm-Rudman. You cannot do it in 12 months.

Senator ROTH. I would say, Mr. Bowsher, you have five because then you have the leadership.

Mr. BOWSHER. I agree with that. I think last year, we put the fifth one there. And no organization can run like that on a timely basis and get the job done.

Senator ROTH. That is Washington's idea of simplification. [Laughter.]

Thank you, Mr. Chairman.

Chairman GLENN. On page 17 of your testimony, you have that the DOD experience with two-year budgeting may not have been all that we thought it was going to be and that some of the DOD people are perhaps re-thinking their support for it, mainly because we did not get enough Congressional support for making the thing work and you indicate you are still looking into that and will make a report to us a little bit later, I gather.

Do you have anything you can tell us about that this morning?

Mr. BOWSHER. Well, I can tell you this. For fiscal year 1989, when Secretary Carlucci sent it over, he told the Armed Services Committee, as I am sure you are aware, Mr. Chairman, that what we are lacking now is the five-year program that did not get sent over last year and so that he is going to have to take out about \$200 billion of programs out of that five-year program that they had in the defense plan previous to that.

So, what we are really waiting for is to see what comes over from Defense to the Armed Services Committee and how it comes over and then how the process will work once you have all the parts. In other words, what we really think is that last year, Secretary Weinberger did not really play fair with the process and gave you an unconstrained budget for the second year and no out year information.

So, what we think we have got to do is see how it is working when you get all the component parts.

Chairman GLENN. To come back briefly to the purpose of our hearing this morning though, as far as all the rest of these reforms go and so on—we are obviously going to have to deal with those over a period of time—but you favor the biennial budgeting approach that is the immediate approach of these hearings; is that correct?

Mr. BOWSHER. Yes. We would favor the biennial budgeting, though I would say that I think unless you do some simplification and streamlining of other parts of the budget process, you will not get the real results that you are hoping for and that is a budget process that works and works well.

Chairman GLENN. Do you have agencies of Government you would suggest? If we wanted to make the biennial budgeting an experiment with several agencies, we would have to include some major agencies in there also.

Mr. BOWSHER. Yes. We sent a letter to Senator Roth a couple of years back and we identified six agencies at the time—Social Security Administration, Veterans Administration, Department of Commerce, Department of Treasury, GSA and the National Science Foundation as being ones that we thought would be good candidates for trying the concept, in addition to the Department of Defense.

Chairman GLENN. Is that because their budgets are usually reasonably stable?

Mr. BOWSHER. Yes, that is right.

Chairman GLENN. Those would be good ones to start out with and see how it works.

Mr. BOWSHER. Yes.

Chairman GLENN. Okay. Senator Heinz.

Senator HEINZ. I just wanted to say that I think the proposal that Senator Ford and Senator Roth have made, of which I am a co-sponsor, is getting a partial testing out this year. We do not exactly have a two-year budget resolution, but we have something rather close to it—a two-year master plan.

It has been this Senator's impression that things have worked a good deal more smoothly and the Appropriations Committees of both the House and Senate have been far better able to come to grips with their tasks. I suspect we have a good shot at passing all the appropriations bills, in fact, before the new fiscal year is upon us and that will be historical.

I would guess also that in a very positive sense of the term, the shift to a real two-year budget cycle would improve not so much the quality of life in the Senate, but the quality of work in the Senate.

In my judgment, by the way, there is really no distinction between the terms. The quality of life in the Senate has to do with the environment in which we all do work and try and do our work and I suspect that beyond the improvements in just going about the budget process in an orderly way, we would find that we did a far better job on the other important issues that we are compelled and we should grapple with.

I have only one question for Mr. Bowsher. I do not know if you have had any discussion of capital budgets at this point.

Mr. BOWSHER. We did have a little discussion.

Senator HEINZ. If you have already answered this question, please tell me so. Do you believe that a capital budget would change the bias that you described, the one which worked against capital programs, into a bias against social programs with a high spend-out rate?

Mr. BOWSHER. I do not think so myself. I know this is often brought up and it certainly is a concern, but I truly believe that looking at your capital items and your operating items and your annual items can be done without falling into that trap. I think the unfortunate thing is when you do not have a breakout between capital and operating, you get such a bias against capital investment that Government tends to remain very labor-intensive and lots of times with very obsolete operations.

So one of the things we put in our prepared text today is a format that breaks operating out from capital and still maintains a unified budget concept, but gives you the breakout and also, between that and the trust funds.

Senator HEINZ. We have, over the last several years, as we have found ourselves in the budget deficit crunch, looking more and more at a smaller and smaller group of programs that account for about 13 percent of all Federal spending.

My concern is that if capital programs are put off somehow on the side, and some of the longer term savings options that are in that capital budget somewhere are shielded because there is a capital budget, will that not put additional pressure on that same, rather small, diminishing group of discretionary programs and outlays?

Mr. BOWSHER. If you did not change the Gramm-Rudman features, I would agree with you. But what I would urge is that if you make any of these significant changes, I would certainly take another look at the Gramm-Rudman process. I would keep the good features of Gramm-Rudman, but I would sure take another look to see if there are not some features of that law that need to be changed.

Senator HEINZ. Mr. Chairman, thank you. I ask unanimous consent that my opening statement be included in the record.

Chairman GLENN. Without objection, it will be included in its entirety.

[The opening statement of Senator Heinz follows:]

OPENING STATEMENT OF SENATOR HEINZ

Mr. Chairman, I am very pleased that the committee is considering the urgent question of budget reform. At the outset, I would like to commend Senator Ford and Senator Roth for their biennial budget proposal. I am a cosponsor of their measure, and I believe that it will help provide a more stable budget process, free up resources that now must go into refighting the same budget battles year and year out, and provide Congress with an important management tool. Congress has a very important oversight role to play, but when a budget resolution is not completed until mid-summer, and reconciliation doesn't begin until the fall, budgeting becomes an omnibus process, where debate and oversight are lost in the rush to somehow complete the process before adjournment.

A two year budget process will help to bring some order to the gridlock that has become so commonplace. We should recognize, however, that changing the budget process will not change the budget deficit. We are spending money faster than we take it in, and we have budget problems and will continue to have budget problems until that imbalance is finally addressed.

A biennial budget will help us to get better control over deficit spending by locking in spending levels for a two-year period. We are already in a two-year budget period right now, thanks to the bipartisan budget agreement. What has been the result? We have seen dramatic improvement in the crafting of the budget resolution, in passing authorizations, and developing appropriations. I think the Senate could get used to a little organization and coherence.

I would also like to welcome my friends and former House colleagues John Rhodes and Robert Giamo, and I look forward to reviewing their testimony, and that of our outstanding panels.

In sum, Mr. Chairman, if we want to streamline the budget process, if we want to help limit the chaos of recent years, we should move in the direction proposed by Senator Roth and Senator Ford. I am proud to be associated with them in this effort.

Thank you, Mr. Chairman.

Chairman GLENN. Senator Pryor.

Senator PRYOR. Mr. Chairman, I just have a request of Mr. Bowsher. First, let me state that I have been very concerned about the process, inasmuch as we have never, underline never, met the deadlines imposed by the Budget Act of 1974. In 1978 and 1979, we missed the May 15th deadline for the budget resolution by only two days. However, we have slipped. In 1985, we missed that deadline by 105 days. In 1986, we were 68 days late. I do not have the 1987 figures.

I do not think there is any incentive built in to the Budget Act to force us to meet the deadlines and, therefore, without any incentive or inducement, we just say, well, we will be a few weeks or a few months late and no one is going to do anything to us. In fact, I even proposed, halfway facetiously, one night that for every day we are beyond the deadline, we not get paid in the House and Senate. That did not go over very well, I want you to know.

But I am just asking you, sir, if you would, to think of options and to maybe give us some options as to a realistic inducement or incentive for us to meet the deadlines. Right now, I do not see and that are either in the law or that are being enforced, and I do not know who would enforce it. So I hope that you would give us the benefit of your views on this.

Mr. BOWSHER. We would be pleased to do that.

Senator PRYOR. I am not asking you to do it now, but please submit it.

Mr. BOWSHER. We would be pleased to do that, but the one thing I think—maybe you were out of the room, Senator Pryor, when I was saying that the real problem, I think, that you have got is you have got too many layers of process existing. When you built the 1974 Congressional Budget Act, you did not take anything out that you had before. Then you put Gramm-Rudman on top of that. And then you have added now the summit and, even some people can say, the debt limitation.

So, you are trying to push through four or five or six different systems here and call it a budget process and I think what you have got to do is you have got to simplify that back down to one or two processes. I think the leadership, rather than the Budget Committees, is key, as I think you are seeing this year with the two-year budget experiment, the leadership decisions that are holding.

Senator PRYOR. Thank you very much.

Chairman GLENN. Thank you very much.

Mr. BOWSHER. Thank you.

Chairman GLENN. Our next panel is the Honorable John J. Rhodes, Co-Chairman, Committee for a Responsible Federal Budget and former House Minority Leader; accompanied by the Honorable James Jones, former House Budget Committee Chairman also. Gentlemen, welcome this morning.

TESTIMONY OF HON. JOHN J. RHODES, COCHAIRMAN, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET AND FORMER HOUSE MINORITY LEADER ¹

Mr. RHODES. Mr. Chairman, first I want to congratulate you and other members of the Committee for having these hearings. I think it is very timely, very important that you are doing it. Before I proceed any further, you have already introduced my colleague to my right here, Jim Jones, a former Chairman of the House Budget Committee. The lady on my left is a former legislative director of the Senate Budget Committee, Ms. Carol Cox, and she is now the President of the Committee for a Responsible Federal Budget.

I must say that when I tell people that I am the Co-Chairman of the Committee for a Responsible Federal Budget, the first thing I see is a smile because there are many people who think that there is no such thing and that the name is a contradiction in terms. We hasten to tell you that we do not think so. We think that our work is important and, in many areas, appreciated and we would like to think that things would be worse, budget-wise, if we were not zealous in trying to point out the facts of life to a lot of people who need to know the facts of life.

Mr. Chairman, there are any number of proposals to alter our existing budget processes. Some would amend the Constitution to require balanced budgets, limit the growth of Federal spending and/or to give the President the authority to veto line items in appropriation bills. Some would amend the Congressional Budget Act. There are those who would abolish the budget process altogether.

Of course, if you were to abolish the budget process, you would have to create something else to take its place. Congress needs badly some system within which to consider overall spending and revenue levels. The resulting deficits and/or surpluses and the relative priority of competing functions within the total budget. You need a system that permits you to consider the implications of this year's budget decisions for the future.

Before I proceed, I would like to address a question that Senator Pryor asked the preceding witness, if I may, concerning the fact that Congress really does not pay much attention to the timetable in the budget process.

Senator Pryor, the only way that I have come up with, a little facetiously, but not completely, is to have the law amended so that if the Congress does not pass the concurrent budget resolution at a given time, that the President's budget then becomes the Congressional budget and the two bodies then may proceed to the appropriations process using the President's budget as the budget of both the Congress and the President.

I say that knowing full well that this really is putting the heat on the Congress because no Congressman in either body would want that to happen, and I cannot think of anything that would possibly act as a goad to get the process on a timetable, which would be more rigid, than providing for something which would be unthinkable. I think my suggestion would be unthinkable.

¹ See p. 163 for Mr. Rhodes prepared statement.

Our economic decision-making processes are the result of evolution. Unfortunately, we tend to layer new committees and subcommittees on top of the old. In the Executive Branch, they tend to create new departments and agencies. Who can remember when last we consolidated Congressional committee jurisdictions or eliminated a department or agency in the Executive Branch?

As a result, we have too many groups of people reviewing the same decisions too frequently, and often making decisions too specific, only to revisit these same decisions tomorrow, next week or next month, so no decision ever seems to be final. The budget process is not perfect, but it is not the problem. The real problem is the problem itself.

The United States today faces enormous deficits, five and one half years into an economic recovery. If you factor out the Social Security Trust Fund surpluses and as Senator Heinz or Senator Roth mentioned the surplus in the highway and the FAA Trust Fund—you factor those out and your deficit becomes even worse than it is.

This is the problem the next President and the new Congress must face and face it as soon as possible. Mr. Chairman, may I have my statement printed in the record as so read?

Chairman GLENN. Without objection, your entire statement will be included in the record.

Mr. RHODES. The principal topic of this hearing is biennial budgeting. There is no reason to revisit each and every decision necessary to run a trillion dollar enterprise each and every year. Biennial budgets and biennial appropriations would provide a longer and more certain planning horizon. They should lead to increased efficiency in Government. They certainly would help to rationalize Congressional decision-making.

They should provide a better basis for evaluation of the effectiveness of Government services and programs. Biennial budgeting, without biennial appropriations, solves nothing. Just look at what happened in the aftermath of the budget summit agreement. If you pass a biennial budget and biennial spending and revenue legislation in the first session of a Congress, the second session could be and should be devoted to authorizations and oversight.

That could improve substantially the quality of Congressional oversight and might once again lead to a meaningful authorization process. We understand the difficulty beginning this process. You must pass fiscal policy legislation in the first session of the new Congress. No new President will want to wait 18 months to see his programs enacted, and you simply do not have the luxury right now to delay the decisions on deficit reductions any longer than is absolutely necessary.

It is our fervent hope that the next President will put deficit control at the very top of his priority list, even ahead of his favorite new programs. The authorizing committees may therefore, complain that our suggested approach effectively deals them out of the action next year. Our response is to say, this really is just a replay of recent years, except this time, the authorizing committees would have a meaningful opportunity to flesh out programs in their jurisdictions and to complete their very important oversight responsibilities in the 101st Congress.

Above all, we must stop tinkering with the budget. We should make the best decisions we can, based on the most prudent possible set of economic assumptions, then let those decisions take effect. Let the system settle down, stop kidding ourselves that any real benefits result from fine-tuning fiscal policy at every conceivable opportunity.

Some say the Congress should preserve the flexibility it has. Well, let me be blunt. Those who like the decisions you make next year will be happy to leave those decisions alone. The losers of next year's fights will want to fight again the next day or month or year, but no one really gains from this perpetual decision-making process. Let us try a longer time horizon and see how well it works.

Mr. Chairman, I am one to solve problems and I quite often do it facetiously. I share your concern that we get so many numbers from so many different sources. One of the things which I think might help is to require the CBO and the OMB each to furnish two budgets—one budget based on its economic assumptions, the other budget based on the economic assumptions of the other. So, if you take the four budgets and put them together and divide them by four, you may have something that makes some macroeconomic sense. [Laughter.]

To maintain credibility in this effort, you simply must demonstrate that you have done everything you can to control the growth of spending. Outlays grew this year \$50 billion over last year's levels. That is as much as the total budget of the State of California. It is the seventh largest budget in the world. Surely, Government spending growth can be contained, but that will require Congress and the President to agree to real spending limits and to agree to enforce those limits and to be bound by the agreements that are made.

Once again, the budget summit agreement provides a point of reference. Four months after the agreement was signed, the Congressional Budget Committees redefined some score-keeping conventions to stay within the agreed to limit. Now, no one likes limits. Someone always will say, what if interest rates go up? Should we cut programs to make up for that?

Well, the fact is, meaningful budgets presuppose meaningful limits on spending, no matter how hard they may be to hold to.

This has been a very brief review of the kinds of budget process change we believe could help to expedite passage of major deficit reduction legislation early next year. We believe passage of a package to move the budget back toward balance should be your top priority, as early as possible, in the next Administration and the new Congress.

We assume that the only way Congress and the next President can act as quickly and as dramatically as we believe they should on the budget deficit, is to act on a negotiated package, whether that package be the product of the National Economic Commission, a budget summit or both or neither.

We believe the kinds of process changes discussed above should be included in the negotiated budget settlement. We do not believe it is possible for Congress to change the budget process permanently at this time. One time budget process changes next year, however, may assist your deliberations on permanent process change.

You could implement the suggestions above on a trial basis, see how they work, and if they work well, you could write them into the law on a permanent basis.

We believe strongly that a biennial budget would be helpful in solving the deficit control problem, but it is no panacea. It will still take the courage of the majority of the House and Senate and you will have to cast some very difficult votes to solve the problem.

If you pass a biennial budget, spending and revenue legislation next year, you could spend the second session of the 101st Congress reviewing budget process change generically and you could complete that review without constant pressure to cut the deficit distorting your deliberations.

Toward that latter objective, we have included without remarks today testimony we delivered last year before the House Government Operations and Judiciary Committees. Mr. Chairman, I would like to submit them for the perusal of the Committee. If the Chair wants to put them in the record, that is fine, but otherwise for the files so that they may be available.¹ We do have some words of wisdom in here that, of course, I did not include in my remarks.

Chairman GLENN. We appreciate that being submitted.

Mr. RHODES. I thank you. That testimony deals with a number of budget process issues, including proposed Constitutional amendments. One of the proposals we deal with in that testimony is the item veto. We were against it then and we still are, but we believe a word of warning is in order.

The omnibus appropriation bill, otherwise known as the continuing resolution, has the practical effect of diluting, if not denying, the right of veto to the President. The Constitution did not mean for this to happen and we think the practice is unwise and unfair to the President.

We strongly believe that enhanced rescission could address these issues, continue the traditional way of appropriating funds, and lead to better teamwork and balance between Congress and the President. It could therefore, help get the deficit problem under control.

Mr. Chairman, members of the Committee, if you would agree to incorporate the balance of our testimony, as you already have, I will pause now and await your questions for me or any of my colleagues.

Chairman GLENN. Thank you very much, Mr. Rhodes.
Mr. Jones.

TESTIMONY OF HON. JAMES JONES, FORMER HOUSE BUDGET COMMITTEE CHAIRMAN

Mr. JONES. Mr. Chairman, members of the Committee, I subscribe to the formal statement that Congressman Rhodes read. I might just make three brief additional points to underscore my judgment.

It is not the process that needs to be changed; it is the politics. I think the first order of business for the next President, be it a

¹ See p. 189.

Democratic or Republican President, is to try to re-establish a sense of bipartisan trust with Congress so that the tough decisions that we all know have to be made can be made in a bipartisan manner. I think that is the only way you are going to get the deficit down and move to a balanced budget.

The second point I would hope is that the Committee and the Congress would resist the siren song of Constitutional amendment panaceas because they are not panaceas. Instead, perhaps, tinker at the edges. Biennial budget, I think, is worth a try. It is not going to solve all the problems and it will only work if the second year of the Congressional session of a Congress be used to truly review what was done in the first year and what needs to be recommended in the next Congress.

Secondly, I would recommend that you look at the rescission and deferral process and resuscitate the rescission process by allowing the President to rescind, but requiring a simple majority of both Houses of Congress to override that President's rescission and that if Congress fails to act, the rescission stands. And if Congress, by simple majority, overrides, the rescission falls.

The third point is, I think Congress is going to have to look inward to its own Congressional process. As, I believe, Mr. Bowsher indicated, we are putting too many layers on top of each other and I think you need to look very dramatically at such basic questions as to whether the Budget Committees, for example, should continue, at least in the present form or whether it might be more appropriate to have an ad hoc budget committee of those committees who have responsibility for implementing a budget, to meet at the beginning of each Congress, to set their budgets so that there truly is a budget and then implement it and get on with the job.

I think those kinds of dramatic moves need to be considered more than Constitutional amendments and these esoteric things that will have no effect.

Thank you, Mr. Chairman.

Chairman GLENN. Thank you, I appreciate your comments. Ms. Cox, do you have anything to add to these comments?

Ms. Cox. I have only one comment and it arises out of the discussion you had with Mr. Bowsher. I do not think it makes a great deal of difference whether you talk about unified budgets or whether you talk, as Chuck talked, about keeping the unified budget, but having separate accounting for the trust funds and capital expenditures, so long as you bear in mind one thing.

Capital budgeting is not a concept that is exclusive to the expenditure side of the budget. Everybody seems to think about it as a way of creating a new category of spending for which we do not have to pay. That does not make any sense at all. If you bear in mind, as you think about how you would array whatever budgets you would have, that you have got to pay for everything you do, whatever column you choose to account for it, I think you will find that the advantages of being in one or another column are significantly diminished and therefore, the kind of competition that Senator Heinz raised, is just not likely to occur.

I do think it is important to bear in mind that whether you use the existing unified budget concept, a somewhat simplified concept, a disaggregation into capital and trust funds and operating expend-

itures—someplace, you have to bring it all back together because you do have to cope with what we call the unified budget deficit and what the European democracies call the public sector borrowing requirements. Sooner or later, you have to know what the Federal Government is doing as a whole.

Chairman GLENN. Good. Thank you. I think we will keep this round to five minutes here since we are getting very late.

We have almost a couple of dozen proposals before us on reform, budget reform—19 before this Committee specifically right now. To make a little bit of order out of this, we asked the CRS and the Congressional Budget Office to look at them. I gave you copies of that. I doubt if you received these previously so I will not ask any comment on it now, but I gave it to you just so you could have it to go through. We might want to call on you to comment on some of those proposals or the observations they make in that little hand-out there.

Your committee does not list financial management reform as a budget reform. Do you think that is in order that you might look at that?

Mr. RHODES. That is a very broad subject, Mr. Chairman, and I am satisfied that any subject that broad could stand some reformation, particularly since it has not been attempted for such a long period of time. I think that it is important in the total package, yes, sir.

Chairman GLENN. Do you have any suggestions, any of you, on the actual components of the biennial approach? For instance, should everything come in one year—appropriations, budget resolution, authorization—and use the other year for oversight, which we never seem to get around to, at least not adequately? Should we do the authorizing and the appropriating separately? Do you have any suggestions on how we do this?

Mr. RHODES. Well, one of the problems is just how you get into the process because we envision, of course, that there would be one year of appropriations and another year of oversight and probably, authorizations. That does not have to be the pattern, but it seems to me that that is a reasonable pattern.

Chairman GLENN. Well, would you recommend authorizing one year and appropriations a different year?

Mr. RHODES. That would be my thought. Jim, I will yield to you on that.

Mr. JONES. I think that would make a lot of sense, at least to try it in that respect. It would give some predictability to these programs for the recipients and the administrators of the programs and seems to make a good division of responsibility.

Mr. RHODES. One of the problems will always be the supplementals and that is why, in part of the statement that I did not read, we suggested that if there are to be supplementals, that at least in the House—and I am not familiar enough with the rules of the Senate to know whether you have a similar procedure—that any supplemental be passed on suspension for various reasons.

One, it is not amendable. You could not make a Christmas tree out of it. Secondly, it has to be passed by two-thirds vote. The third is, the leadership is responsible for bringing up bills on suspension.

So, you would not be bringing up something that the leadership would not have approved.

Chairman GLENN. We do have some different rules that apply in that case.

Mr. RHODES. I am sure.

Ms. Cox. I think though, Senator Glenn, if I may, that if you think about a meaningful biennial budget process, probably the most difficult task you face is to devise some process to make it very hard to pass supplemental appropriations in the off year. If you do not, you will be right back into annual budgeting because the inclination to spend money is just so much stronger than the inclination toward oversight and solid work on authorizations, that it will be a siren song that you will only resist if you set up processes that make it very difficult to do.

Chairman GLENN. I think your words of warning are well taken, but I would also make a word of warning of my own that we do not lock it in so tight that you cannot have a supplemental because you are going to have emergencies, you are going to have things occur and ups and downs in departments, things you cannot see. We have an AIDS epidemic. We need several billion for that. That comes up and you cannot wait on something like that. So, I would not want to lock it in so tight that supplementals are near impossible.

Ms. Cox. Oh, I agree with that. I just think that there are things you can do to make them more difficult and that you ought to think of that.

Chairman GLENN. Senator Roth.

Senator ROTH. As I understand your testimony, what you would recommend is adopting the biennial for a two-year trial basis. My concern is that we will spend all the next two years in arguing that, rather than proceeding because I think there are a number of additional reforms that need to be made. What bothers me is how we build the will. I think we have a fairly broad consensus now, both in the House and Senate, on the biennial and we ought to take that step now.

We can always undo it if it does not work well, but I worry that if we do it on a trial basis, that that is going to be the focus of attention.

Mr. RHODES. Thank you. Actually, I am glad you brought this up because it was not my intention to indicate a time limit on the two-year budget. I do not think you can test it meaningfully in just two years. But we did mention that in that off year, you could do whatever you need to do to generically improve the entire Congressional budget process. We did not intend to attach that proviso to the biennial budget.

Senator ROTH. I see. Well, I agree with that. I think we have to move ahead. Going back to what you call an ad hoc committee, Jim. Well, a lot of people have called this a leadership, where you would have the Chairman and the Ranking Members of the appropriate committees. Are we talking pretty much the same thing there?

Mr. JONES. Yes, I think so. I think when you look at it, on the House side at least, Ways and Means, Appropriations, Commerce and a handful of other committees do all the revenue raising and all the spending, either by entitlement or appropriations. They are

the ones that are responsible for implementing a budget and they ought to be on the input—or, at least, the leadership of them—from the very beginning and put the responsibility on their shoulders to actually not just the budget that is a piece of paper, but something that is going to be implemented.

Senator ROTH. Well, to me, that just makes good sense and I think that is a move we should certainly give serious consideration to. Going back to your experience on the budget process itself—I do not know whether you were here when Senator Domenici was here—but as I indicated earlier, when we originally passed the Budget Act, it really was not intended—at least it was not my understanding—that the Budget Committees were going to get as involved in detail as it has in the past.

As I understand the argument, you have to know the bricks before you can build the wall and that is the reason for that. But now, Pete Domenici has come up with a suggestion of a limited budget. Is that workable? Is that a sound suggestion?

Mr. JONES. I was not here when he testified and if he is talking in broad macroeconomic terms, I guess it is possible, but it is just one more sham in the budget process. I think so many people cast their votes and beat their chests that they cut the budget or did this or that and it has no meaning. As a former Chairman, I can tell you, every year you find a new gimmick to pass a budget and then all kinds of gimmicks to enforce it. All I am suggesting is, you take as many gimmicks out of the process as possible and get on with the business.

Senator ROTH. I think what he was suggesting is that the breakdown of the overall budget be relatively simple, maybe three or four or five categories, discretionary, military, foreign aid, possibly one or two others, rather than this great detail that has—

Mr. RHODES. I was on the study committee that came up with the Congressional budget process and I think Senator Domenici is correct as far as the intent of the committee was concerned. It was never intended to delve deeply into minutiae of the Government and spending processes. It was intended to be a study in macroeconomics and to, rather loosely, apportion whatever the Budget Committee felt would be the proper amount of assets that the public sector should take away from the total assets of the country.

In other words, it was sort of to apportion the wealth of the country with the GNP, let us say, between the public sector and the private sector.

Senator ROTH. Well, that is absolutely right. That was the intent, at least as I understood the intent, to be overall and, of course, I think your suggestion that if the Budget Committees were made up of the leadership, it would be much more likely to do that than the way it is constituted today.

Mr. RHODES. Well, one of the things which we did and we had to do because, as you will recall, Senator Roth, because you were there—we had a tough time getting that budget process adopted. The committee chairmen did not like any part of it because it was infringing on their turf. In fact, if it had not been for the genius of Dick Bolling in putting that rescission part on the Budget Act, I do not think it ever would have passed because the committee chairmen were so angry at President Nixon over his rescissions that

they were tickled to death to vote for the total package as long as the rescission was there.

Mr. JONES. I believe the driving force was the impoundment, not the budget in 1974.

Mr. RHODES. That is right.

Mr. JONES. And there has to be some organization—if it is the Budget Committee or the leadership—that enforces the micro aspects that fit into the macro intent.

Senator ROTH. My time is up, Mr. Chairman.

Chairman GLENN. Senator Pryor.

Senator PRYOR. Thank you, Mr. Chairman. I thank all the witnesses this morning. You have been very, very helpful to me. I am very interested in something Congressman Jones said, especially having been a past Chairman of the House Budget Committee. One thing that I think I heard, Jim, was that you said we might not actually need a Budget Committee in the House and Senate.

If we replaced it with an ad hoc group of individuals who set what, a ceiling on expenditures, a ceiling on appropriations, would such an ad hoc group possibly consist of the subcommittee chairmen of the Appropriations and the chairmen of the authorizing committees of the House and Senate? Would something like that work?

Mr. JONES. That would be my suggestion, that the committees who are actually spending money by discretionary appropriations or by entitlement have jurisdiction over that and the committees that are raising the money would be the leadership of those committees plus the House and Senate leadership. They would make up the Budget Committee on an ad hoc basis each year and would have to look at the total picture, have full responsibility for developing the budget and then immediately thereafter, implementing it, not just passing a piece of paper and then wrangling the rest of the year on implementing it.

It just seems to me that that cuts out one layer of cost and of process. You still have the Congressional Budget Office that is exclusively for Congressional use, so you have that kind of professional talent. It is making more and more sense, I think.

Senator PRYOR. There would be a possible issue that I would like to raise with you and I guess that gets to reconciliation or rescission. Is it conceivable—I ask you this because of your expertise in your former Chairmanship of the Budget Committee—would it be conceivable under the ad hoc approach that any additional revenue over that ceiling that the ad hoc group had recommended or had gotten passed in a resolution in the House or Senate, might have to have a super majority, for example, two-thirds in the Senate, to appropriate or to extend over that particular ceiling?

Would that serve as sort of a break at the end of a legislative session to make sure that Christmas trees, as Congressman Rhodes has suggested, are not in?

Mr. JONES. Right. You could do something like that or on the House side, something similar to what Congressman Rhodes mentioned, the suspension calendar process which would limit it to no amendments and I think it is a 60 percent majority to pass it.

Senator PRYOR. One final question, Mr. Chairman, if I may.

Congressman Jones, do you feel that the Budget Committees in the House and Senate have started legislating in the minutiae and the nitty-gritty of Government to the extent that they are getting too detailed? Is this an opinion of yours?

Mr. JONES. I think in the last couple of years, that there has been a reversal of that brought about by the economic summit, et cetera, but anybody that has served on the Budget Committee knows you have absolutely no power and it is only the smoke, mirrors and all kinds of things that you can create that gives you any power. You are a supplicant to everybody else to implement it. I guess it is a nice honor and all of those kinds of things, but I am just questioning whether or not it actually gets the job done.

Senator PRYOR. Thank you very much.

Mr. RHODES. Senator, may I comment briefly?

Senator PRYOR. Yes, sir.

Mr. RHODES. We started out in the process with the second concurrent budget resolution, which was to be at the end so that the Congress could look at what it had done and, of course, the breakdown of the calendar, as you mentioned before, was the main reason that that did not work because you did not have your appropriations bills done by the time that you were supposed to have done the second concurrent budget resolution.

And also, you were always afraid that the last appropriation bill would take the brunt of any reduction that had to be made in order to get within the target because all of the other bills would have been adopted and had become law. That is usually the Defense bill, as the Chairman well knows.

The gentleman from New York, Mr. Conable, had a very brilliant idea, I thought, and I guess it might have been original with him. The idea being that you would proceed to pass appropriations bills, but not have them enrolled and keep them at the desk of the Speaker of the House and the President of the Senate, until all bills had been passed, except for enrollment.

Then, at that time, the two bodies could look at what they had accomplished and if any reductions had to be made, they would not have to be made out of one bill. They could be made out of any bill and it could be done by resolution. I just suggest that that might be something you want to consider.

Chairman GLENN. What you are doing with that process is making a good case for a CR approach to this whole thing. Wait until the end of the session and then put them all in one bill.

Mr. RHODES. Well, except that the main problem with that, Mr. Chairman, is that the President really does not have any choice as far as veto is concerned and I do not want to give him item veto.

Ms. Cox. May I say just one thing?

Chairman GLENN. Yes.

Ms. Cox. I do not want to discourage anybody who wants to simplify our budget processes, any budget process junkie like me feels very strongly that we need to do that. I am just concerned that we face an enormous deficit reduction problem and if we wait until we get agreement to consolidate Congressional committee jurisdictions to solve that problem, we may be here a lot later than I would like to be.

I think it is such a desirable objective I do not want to throw any cold water on it at all. I just have never seen a single subcommittee's jurisdiction consolidated, much less whole chunks of the operations of the House or Senate. As desirable as I think it is, to talk about that as a step towards doing what has to be done, I find just a little bit dismaying the thought of so much delay.

Chairman GLENN. Good. Thank you all very much. We appreciate it.

Our next witness is the Honorable James Miller, Director, Office of Management and Budget. Mr. Miller, we are glad to have you with us again. I know he has had a conflict this morning and has arrived just in the nick of time here. I know you are a busy man—testifying over in the House and here and all over this morning. We appreciate you being with us.

TESTIMONY OF JAMES MILLER, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. MILLER. Mr. Chairman, thank you for the opportunity to be with you, Senator Roth and others. It is a great pleasure to address this issue. Mr. Chairman, I think you and your colleagues have a chance to do for the Congress and the President and the American people a great favor and that is to repair the budget process.

It should be plain for all to see that the budget process has broken down. I believe a Congress that must be sick to death of the current system and an Administration about to go out of business are uniquely positioned to make an historic break through. I believe the American people deserve it and I know that we who grapple with the budget year after year could stand some relief.

Mr. Chairman, let me suggest three questions, implicit criteria, if you will, that ought to guide us in our consideration of the budget process. First, is the budget process efficient in the sense of being relatively costless and delivering decisions in a timely fashion? Second, does it result in informed decision-making—that is, do members of Congress and the President know what decisions they are making about the budget? And third, does the process tend to lead to spending decisions that are more or less in keeping with the will of the people?

By these three criteria, I would argue, the budget process has failed. Certainly, no one can claim that the current system is anything but terribly costly in terms of time, not to mention the wear and tear it imposes on members of Congress and those of us in the Executive Branch alike. Year after year, Congress violates the Budget and Accounting Act, failing to enact appropriations by the beginning of the fiscal year, and then only after what may be described as a most acrimonious and otherwise unpleasant series of confrontations.

Do members of Congress know what they are voting on? I will tell you what. I will give a dollar out of my own pocket to each member of Congress who claims they read, much less understood, last year's reconciliation bill or the continuing resolution.

Chairman GLENN. We could not lift it, let alone read it. I think we weighed it, did we not, last year when we had the summit meeting in December?

Mr. MILLER. Waived it?

Chairman GLENN. Weighed. I think it was 14 pounds, as I recall.

Mr. MILLER. At the State of the Union, the President held it up.

And did the President know what he was signing? Well, he had advisors to tell him, but let me ask you. If you had less than 12 hours to review the reconciliation bill and eight hours to review the continuing resolution, what level of detail would you have about either? So, two down, one to go.

Does the current system lead generally to decisions that comport with the will of the American people? I suppose, in a general sense, the answer is yes. There is certainly room for improvement. Entitlements seem to grow and grow despite public demands they be addressed. The situation has gotten so bad that entitlements make up half of the programmatic budget. They are widely referred to as uncontrollables.

Appropriations keep growing, though at slower rates recently, due in part to the budget discipline of Gramm-Rudman-Hollings. Moreover, we continually stick into appropriations language and in report language, reams upon reams of special interest funding commonly called pork. The situation is so bad that when in the State of the Union, the President points this out, belly laughs shake the rafters. Congressmen, Senators, and guests rise to their feet and give him a standing ovation. This is budget process?

Who is at fault? Well, surely we in the Executive Branch bear part of the blame, if only because from time to time we disagree with the spending priorities Congress sets before us. Most of all—and we have missed a few deadlines, Mr. Chairman, as you know—but most of the fault, I submit, rests here on Capitol Hill, not that you would ever know it.

The appropriators blame the budgeters. All was fine before the 1974 Act, they say. The major problem is that they, meaning budgeters, hold us up, having missed all the deadlines for the budget resolution. The budgeters blame the appropriators. If only they would follow our instructions, say the budgeters. They keep playing games.

Members who are neither blame both and the appropriators and the budgeters respond, they do not know what the budget process is like and they want everything handed to them on a silver platter. I will not dwell on who is at fault. Suffice it to say that everyone needs to open his or her eyes to the situation and open his or her mind to a consideration of alternative solutions.

What are these solutions? They are many and varied. That is to say, many proposals have been advanced and each proposal has its own variations. Take, for example, the line item veto. Is it an all or nothing veto? Or like ten State Governors, should the President be allowed to mark down the amount, a power that is referred to as the item reduction veto?

Or what about the variant called enhanced rescission authority? And is this line item veto to be enacted or put in the form of a Constitutional amendment? Also, we might consider combinations of individual proposals. For example, there is no mutual inconsistency in having a line item veto, biennial budgeting, a balanced budget amendment, and individual appropriations bills as opposed to a continuing resolution.

Let me state straight-forwardly that the Administration's position is that a combination of measures is called for. Specifically, let me draw your attention to the President's message in the fiscal year 1989 budget, wherein he called for enactment of balanced budget Constitutional amendment, a line item veto, averting the concurrent budget resolution into a joint resolution, individual transmittal of appropriations bills, strict observance of budget resolution allocations, enhanced rescission authority, biennial budgeting and truth in Federal spending.

Now, we continue to stand by these proposals and urge Congress to enact them. Having them in place would make the decision-making process less costly and less time-consuming. More specific and rigid rules of procedure would convert what is now a regularized form of anarchy into a rationale discourse on priorities and timely action. Participants would know what they were deciding. Moreover, they would better understand the decision-making process itself.

I cannot tell you how often I have observed, on the part of members of Congress, a surprising degree of confusion, as well as consternation about the current budget system and how it functions. The current budget system is so terribly complicated and unclear in its application.

Finally, I think these reforms would yield results that are more in keeping with the public's demand for frugality and restraint. Let me explain. There is widespread belief that the budget process does not matter. I hear this all the time. Well, I would note first that many State governments have some, if not all, the budget conventions I have described and they seem to get through their budget cycles with a great deal more ease and timeliness than we do at the Federal level.

There are those who say that such things as a line item veto or Constitutional amendment to balance the budget would have no effect on budget behavior. Recently, this view was bolstered by analyses based on State budget data; that is, estimates of the effects of these institutional arrangements based on ordinary cross-section time series regression techniques.

One of my associates at OMB, Dr. Mark Crain and I reviewed this literature and found it lacking. A major problem is that it lumped together too many budget institutions that are really quite distinct. Let me tell you what we found from our work. First, while the all or nothing version of the line item veto seems to have little effect on the growth of spending, the item reduction veto—the kind President Reagan had when he was Governor of California and the kind that Governor Dukakis has in Massachusetts—has a decisive effect on the growth of spending.

Other institutional arrangements, likewise, have a significant effect on the growth of spending. These include a Constitutional balanced budget requirement, having separate appropriations bills instead of an omnibus bill, requiring all spending to be appropriated every cycle—that is, no uncontrollables—and requiring a super majority to enact a tax increase.

The point of this, Mr. Chairman, is that those who say the budget process does not matter have it all wrong. The budget process matters and it matters quite a lot. With that point, Mr. Chair-

man, I will stop and be prepared to respond to any questions that you might have.

Chairman GLENN. Thank you very much, Mr. Miller. Let me get to it here.

From the Executive Branch viewpoint, do you have a preference, from your view, as to how the Congress should operate if we put in this biennial budgeting? Should we put the budgeting goals that we have to submit or decide under the Budget Act, and the authorizing process and the appropriation process all together in one year? Should we split them up? Which should come first? You are the ones that have to execute these things down there and coordinate these things with us. None of us operate alone.

Mr. MILLER. Yes, Mr. Chairman. You can imagine at one extreme doing essentially the appropriating in the first of the two years, and essentially oversight the second; or you could do a lot of oversight and then appropriating. I think a two-year budget cycle makes a lot of sense. Many States have it. We have done a little bit of work with the Department of Defense. Mr. Helm will be talking about that, I understand, in a few minutes.

I think we ought to move in that direction. If you want to know my personal view, my personal view is that we ought to collapse the appropriations and authorization committees into one instead of having separate committees. That is my own personal view and I think that you could do the oversight and appropriations on a two-year cycle and do it rather well.

Chairman GLENN. You would keep the overall budgeting committee and the budgeting process?

Mr. MILLER. Mr. Chairman, I think there is a lot to be said for setting the parameters of the overall budget and then filling in the details and that is what the budget process is supposed to do. The budgeters, essentially, define the overall parameters and then the appropriators fill in the major details.

I think, Mr. Chairman, the experience that we had last November, while it was long and drawn out and it came only after a rather significant adverse event in the markets, does show that we are capable of putting together a two-year budget and carrying through reasonably on it. I think this is something that we should emulate.

Chairman GLENN. You had a line up there, line item veto, biennial budgeting, balanced budget amendment, individual appropriations bill—I agree with you on a couple of those and a couple we could debate for a day or so here as we have been for a number of years already around here.

I would not agree with you completely that all of this is the failure—I think you implied that most of this or all of it is the fault of Capitol Hill. I think we have to work together on these things.

Mr. MILLER. Oh, absolutely.

Chairman GLENN. We do not operate in solo here and I have a bill I put in. We had it passed in the Senate twice; it failed over in the House. It is still S. 86 and what it—you know, when we put a budgeting process in that you live with to this day, the budgeting process was started back in 1921, I believe. Before that, the President did not even have to submit a budget to us.

Mr. MILLER. That is right.

Chairman GLENN. And that thing says that where the President submits a budget to the Congress, as is required every year, that the President will submit a budget that is in balance or if it is going to be out of balance, the President will suggest appropriate action where the budget is going to be out of balance.

Now, appropriate action is defined, down in the U.S. Code in the fine print at the bottom of the page—and I did not bring that with me this morning; I did not know I was going to quite get into this this morning in response to you—but, the appropriate action is defined as “he will suggest new revenue, he will suggest borrowing, or he will suggest other appropriate action.” That is the way it is defined down there in fine print.

Now, every President, I guess, since time immemorial, since that was passed back in the 1920's, when they submit an unbalanced budget to us, they automatically ask for a debt increase to go along with it. And so here we are. Two and a half trillion dollars in debt and no President ever, Democrat or Republican has done the tough thing that should be done and that is, along with an unbalanced budget, either tell us I have got to have taxes or here is my plan for cutting it down to size to make it balance.

They have already said, no, we go for the debt increase, more borrowing and that is it. So, it is a cop-out. And this President is no different than any other President. The figures that you people have submitted to us over here have not addressed that and that effect and it has always aggravated me that the President submitted the most unbalanced budgets in all American history to us and within 30 days, was raising Cain with Congress for not cutting out more of what he just submitted to us 30 days before.

When he had the capability all the time, if he is that concerned about it, to submit a balanced budget to us or tell us how to get there. And we are going to get this thing passed someday around here and we are going to require Presidents of whatever political stripe, to do exactly that.

If they are submitting an unbalanced budget to us, then tell us how to get there, other than debt increase. Either tell us where to cut because they are the people that have the leadership of the country. There is not any doubt about that and they are required by law to submit the budget.

So, we are going to get that passed sometime and so, I do not accept your implication, if it was that, that all the fault lies on Capitol Hill. I take exception to that for those reasons. The President has budget leadership. That is where it resides. That is what is in the law and I support that. But we have our own set of problems up here and when we make our corrections here, to make our own operations more efficient, they have to be done in harmony with what you do and how you submit the budget to us.

Mr. MILLER. I accept that without reservation. There are things that obviously we need to work together on, Mr. Chairman, and there are things that we could do better that would help you. I do not think there is any question of that. We do, in the budget, I think though, pursuant to the agreement that we reached last November, talk about how we can gradually get that deficit on down.

In just very simple terms, what you have, if the economy continues to grow, it depends on what stage you are in the tax reform.

That has had an undulating effect on the revenues. But this year we will pick up about \$50 billion in new revenues just from economic growth alone. Of course, we have the phasing in of the—

Chairman GLENN. Senator Roth pointed out a thing a little while ago that I think was very good, too, and I had not quite thought about it in this way until he pointed it out. I was talking about the authorizing process, the appropriating process, then we put on top of that the big canopy of Congressional budgeting process, and then we went ahead and now we have passed Gramm-Rudman, which is another process that impinges on all of that and then we had our budget summit last December that took over from all that and went above Gramm-Rudman and everything else.

So, we literally have five processes, five layers right now that we are working within in this session of Congress. My time is up. Senator Roth.

Senator ROTH. One thing we really have not dwelled on at any length, at least as far as the deficit is concerned, is in many ways, I think that it is a product of divided government.

There are different philosophies and different priorities and the easy way to work out those controversies is to add more to everything, without blaming either the Congress or the White House or the House or the Senate because there are differences here among us.

And yet I think that is a fact of life we probably are going to continue to face as a general rule. Does the so-called summit or leadership provide a worthy approach to try to bridge those differences?

Mr. MILLER. Oh, I think so. Let me just mention, however—stress the fact that many States have the same kind of problem. They have houses that are split down the middle; some on one side, some on the other; Governor of the same party, Governor of the different party; et cetera. But they seem to do their business and get the budget out and get it done much more cleanly and efficiently than we do at the Federal level.

I think the bipartisan budget agreement—we were there for 20 days and 20 nights basically—and it was a long time, a lot of back and forth, staff was in, staff was out. People began to feel each other out for what their views were, et cetera. But I think it does hold a model for us to look toward in the future. It seems to me that if you converted the current resolution, the budget resolution, into a joint resolution, then you would essentially force a coming together of the Congress and the President early on in the budget process during the year.

So, in other words, if you made that a joint resolution, you would have something like a budget summit every year. If you could make it a two-year budget cycle, I think that would even be better. That is what we essentially have for these two years—1988 and 1989.

Senator ROTH. Mr. Chairman, the time is drawing late, so I will end.

Chairman GLENN. Thank you very much. We may have some additional questions we will wish to submit to you. With an eye on the clock though, I think we will end. We appreciate very much you being here today.

Mr. MILLER. Thank you, Mr. Chairman. It was good being with you.

Chairman GLENN. Thank you.

Our last witness today—and we appreciate his indulgence with us in waiting this long—is the Honorable Robert W. Helm, Comptroller, Department of Defense. Mr. Helm, welcome to our hearing and we are sorry you had to wait so long here, but it has been an interesting hearing this morning and we had a lot of questions and a lot of participation, as you are aware.

You have had some experience in the subject of our hearing this morning—the biennial budgeting process, albeit maybe on a rather limited scale so far, but we have been sort of feeling this out for the last couple of years to see how it worked and we appreciate your testimony.

TESTIMONY OF ROBERT W. HELM, COMPTROLLER, DEPARTMENT OF DEFENSE

Mr. HELM. Thank you very much, Mr. Chairman. I am glad to be here. The hour is late so I will be very brief. I have prepared a statement, which I would submit for the record,¹ if I might, and then just very briefly summarize this.

Chairman GLENN. Without objection, your entire statement will be included in the record.

Mr. HELM. Thank you very much. Mr. Chairman, I would congratulate the Committee, on behalf of the Department of Defense at least, for holding a hearing on the general subject of biennial budgeting and the budget process overall.

The subject is, all too often, regarded as rather mystical or revolutionary by those not intimately familiar with the budget process, but at least for those of us at DOD who have been very much involved in this subject, we regard it as a very prudent and very desirable step towards providing greater predictability and stability, particularly in terms of budgeting for our national security.

Mr. Chairman, we are biennial now over at the Department of Defense. We submitted, you may recall, a biennial budget for fiscal year 1988-89 at the specific direction of the Armed Services Committee and the authorization bill. But it was a direction we were very glad and anxious to follow. Both Secretary Weinberger and Secretary Carlucci were and are strong supporters of the biennial budgeting process.

As you know unfortunately, it was not acted upon in the final analysis in total. fiscal year 1989 was not authorized and appropriated as part of a biennial package. Instead, the developments moved into the budget summit, an environment in which the fiscal guidance for fiscal year 1989 was changed from what it had been when the biennial budget was prepared and the Department, necessarily, had to go through the process of preparing fiscal year 1989 a second time to deal with the reductions incurred in the budget summit agreement.

We are, however, still committed to biennial budgeting and we are, at this moment, preparing an fiscal year 1990-91 biennial

¹ See p. 174.

budget and are very intent on pushing the concept, by example. And we are willing to put up with the extra work of doing the second budget twice until the Congress catches up with us. But as I said, we are institutionalized.

There is some disgruntlement, I must confess, in the lower ranks of the budget community in the Department. It is a lot of work to go through redoing that second year if Congress does not decide to enact a biennial budget and there is some despair that perhaps that may not ever happen, but I take this hearing as an example of real intent to pursue this.

There are real management benefits, for DOD and its contractors and also in terms of the best utilization of the Congress' time associated with a biennial budget, especially in the procurement area, Mr. Chairman—and I know you are well aware of this from your vantage point on the Armed Services Committee.

I cannot overstate the benefits of biennial budgeting for procurement, being able to give program managers their funding up front so that they can pursue, in the most efficient fashion, the best type of defense procurement management that we should all expect for taxpayers' money.

At the moment, under this annual process, especially with the delays that are incurred, program execution is always on the tenterhooks of the budget process waiting for the various steps of the process to be completed until we can move out and actually start obligating the funds and managing the programs.

So, as I said, I cannot overstate the positive benefits of the management results of biennial budgeting. Since we did not, at least formally, go through an fiscal year 1989 budgeting process, we were able to use that second year, free year, if you will, inside the Department of Defense, pursuing an implementation review.

It gave us the luxury at the senior levels of the Department's management to review how well we were doing on these programs and whether, in fact, we were achieving the goals upon which we had built the budgets. That time to pause, if you will, and see what the results were, we found to be very beneficial.

Indeed, we are incorporating the results of that review into the fiscal year 1990-91 budgeting process. So, that has been a positive benefit. I think Congress would see the same benefits in terms of providing some time for a real oversight function, rather than being constantly caught up in the tyranny of the numbers, racing with the budget clock every year. There is no reason, really, that this could not all be done in one year and free that second year, if I can be so bold as to make that suggestion as far as the Congress' own work time is concerned.

In summary, Mr. Chairman, from the DOD perspective, we see no obstacles to biennial budgeting, doing it and making it work. Any complications alleged or artificial, in our view, can be handled very well. Quite simply, my conclusion is, if one wants to make biennial budgeting work, it will. If you do not want it to work, you can think of a thousand reasons why it is not the right step to take.

I am definitely in the former camp and Secretary Carlucci is as well. The challenge lies clearly before the Congress, Mr. Chairman, and to be very explicit, from our perspective, what we would most

like to see would be a two-year authorization and appropriation up front, providing funds for two years to move out and manage programs.

Mr. Chairman, you are intimately aware of the various so-called appropriated, not authorized, wrangles that we get into all too often in terms of defense funding. Other parts of the Government may be different, but our ability to obligate appropriated funds is so dependent on having the authorization in place that I would certainly come down very strong on doing both the authorization and appropriation in the first year.

I am well aware that although the authorizers led the way, there is great resistance, to be blunt, in the appropriations committees, but we are talking to our appropriation committees, trying to encourage them and certainly support this whole effort. So, with that, Mr. Chairman, I will stop my comments.

Chairman GLENN. Thank you very much, Mr. Helm. I appreciate that very much.

In the Comptroller General's statement—if you have a copy of that, I do not know whether you do or not—but on page 17, he had, in commenting on DOD's experience with this, the third point he made was:

Third, questions were raised over the accuracy of the DOD budget estimates, especially the second year estimates.

I believe that DOD officials are re-thinking their support for biennial budgeting, partly due to a perceived lack of Congressional support and partly because of some problems encountered in the Department itself. We are now looking at the DOD experience and will report more fully on it in the near future.

Your testimony this morning is that that is probably not correct and I would assume that people might complain because of the extra work, as you said, of a second year—having to run out a second year estimate and they are not too happy about that. But as far as getting on with the process, I would—you know, it is a learning process for all of us at this end—this side of the river as well as over there.

It seems to me that we do not want to make too harsh judgments on the process out of the very short experience we have had so far. It would seem to me that once we get into this, some of these things become far more routine and more manageable than they are the first time we try it.

Mr. HELM. Well, I totally agree with you, Mr. Chairman. It was a new thing in the Department. We have our bureaucracies within the Department, which will resist change just like bureaucracies will anywhere, but I found that once you drove the spike through the first six inches of skull, it went very easily the rest of the way. We are biennial and are going to continue in that way.

Chairman GLENN. Making economic forecasts is critical here and in your Department also. We are concerned about that. We are particularly concerned about our ability to forecast far enough out and accurately enough to make this work. Do you have any suggestions for making this process less sensitive to economic variations?

I guess a sub-question to that would be, do you have things within the Department of Defense that are very stable budget

items and others that fluctuate more and should we break these out so that we know those differences and know there may be those areas of variation going in? Is that a different way of doing it?

Mr. HELM. Well, certainly parts of the budget are relatively easy to predict—pay, military personnel funding, for example. Procurement and, to a lesser degree, research and development have relatively stable plans associated with them. When, in fact, we contract our larger programs, they have clauses in them which accommodate changes in economic assumptions, inflation, what have you. So, those are taken care of.

In the O&M arena, clearly, there the Department and indeed, our whole national security, is somewhat dependent on what is happening in the world. In terms of biennial budgeting though, clearly it offers its biggest benefits and is most useful and, I think, needed in the procurement and the research and development area.

We have to deal with economic instability in a number of different ways. In the last year, the drop of the dollar overseas has caused a severe problem for us. I think that has to be dealt with on almost a day-by-day basis and I would not argue that we should burden this innovative approach of biennial budgeting with trying to solve each one of those little things.

There will have to be modifications made in each year. Someone mentioned the issue of supplementals and things like that. Those are always occurring on the margins though, Mr. Chairman, and the great core of the budget is not affected by those kinds of concerns, at least in DOD and in the procurement arena, in particular.

Chairman GLENN. One of our biggest problems—and I just make this as a statement and not as a question and then turn it over to Senator Roth—one of our biggest problems with Defense and working on the Armed Services Committee in addition to being on this Committee is covering the stretch-outs when we run into a budget problem. The stretch-outs are horribly wasteful.

Just as an example, the figures on the M-1 tank. The optimum production level was 800, I think, a year. We cut back last year to what 740, whatever it was—750, 760—something in that ballpark. And this added \$100,000 per tank to the cost of the tank. This year, the first proposal was that we were going to cut back to 580, I think it was, because of the budget problems. This was going to add another \$150,000 to the cost of that tank.

Now, we know we are going to get the number of tanks we want. We have to have them eventually. But we are adding then, if we had done that in those two years, that would have added a quarter of a million dollars to the cost of every tank coming off the line. It is just crazy when we do the stretch-out things like that. Now, that was done so we then did not have to cancel some other program or have a new start that we particularly wanted, but it is a very, very wasteful way to do things.

The point I was going to make was, you can make a good case for not biennial budgeting, but quadrennial budgeting or quinquennial budgeting or something.

Mr. HELM. Well, Mr. Chairman, Secretary Carlucci has already said before a Congressional forum that he would be very happy to

submit a five-year procurement budget if he could be assured that he could get a five-year appropriation to enact it because it is all dependent on your assumption of when the money is going to be available. But we very much agree and, as a matter of fact, no stretch-outs are one of Secretary Carlucci's three inviolable dictates to the Department, as we put this 1990-91 budget together.

Chairman GLENN. If you are buying things that are a constant cost, if you are buying 500 trucks from Detroit—they are going to be there and they are a standard truck. Let us say they are a standard pick-up truck or whatever.

Mr. HELM. Very little technical risk, yes, sir.

Chairman GLENN. And a stretch-out on that or putting off the purchase until next year does not mean the price of that goes up substantially—it would go up a little bit with inflation or whatever, but it will not go up substantially. But where you have a specialized item like a fighter plane or a tank or something like that and you stretch that out, you just add enormously to the cost of it.

Mr. HELM. Yes, sir.

Chairman GLENN. Senator Roth.

Senator ROTH. Mr. Helm, I find your testimony very helpful for a number of reasons. First of all, the Pentagon does have a large share of the Federal budget. It is an extraordinarily complex budget because it involves many different things from procurement, which you and the Chairman have been discussing, to running schools, to research and development. So, I think the fact that you and Secretary Carlucci and his predecessor, as different in styles as they were, find this a positive experience is very significant and I appreciate you being here for that purpose.

It seems to me that experience does have significance for the Government at large. In other words, if it can work in as complex an operation as the Pentagon—I doubt that there is any other as difficult—it should work in the others. Would you agree with that?

Mr. HELM. I would think so, Mr. Roth. I think, based on my experience and I have been watching Federal budgeting for ten years now from various vantage points, including the Senate Budget Committee at one point, I think clearly we have the most complex budgeting process in DOD. Many other departments are basically concerned with operating expenses or with managing entitlement programs of various sorts.

So, complexity is a good deal less and I think if it can work in DOD and I think we have proved internally it is working. We wait for the Congress to give us more flexibility to prove it out in its final steps.

Senator ROTH. Well, I guess at least for this Senator, it indicates to me that there has been adequate demonstration that the system will work.

Let me raise a second point and it is one that you touched on earlier and I think an interesting observation that many of us have said it will help Congress be more effective because that second year, we can spend more time on oversight and authorization. But from your testimony, it has the other benefit as well that enables your management and others to concentrate likewise on how successful and efficient your operations are.

Mr. HELM. Very definitely, Mr. Roth, without a doubt. The focus is on the number of steps in the Congressional process, but one has to realize that there is a whole bureaucracy dealing with preparing for each of those steps internal to each department. So, you are really squaring the whole process in terms of the amount of activity that is going on. So, we found that to be very useful and a much needed chance to free ourselves, as I said, from the tyranny of the numbers and look at the real issues. It is very valuable.

Senator ROTH. Finally, in the procurement, it seems to me that a two-year budget is very helpful in your dealing with the contractors or the private sector.

Mr. HELM. Exactly.

Senator ROTH. Would you agree that that experience would not only hold true with private sector contractors, but your schools, your local officials, your State officials if they know a two-year provides for better planning, better management, better utilization of money?

Mr. HELM. I think so, Mr. Roth. Managers, program managers, in whatever arena they are in, I think regard the current budget process with only one thing and that is total uncertainty. They cannot be sure of anything and that puts constraints on management initiative—willingness to go out and push for the best possible deal, I think.

If you provide them with the dollars—and indeed, we saw in the early years of this Administration when the Congress was providing very large resources to the Department of Defense, there was a confidence which I think sort of parallels the kind of confidence you would get with a biennial budgeting process. We saw lots and lots of contract savings come in as program managers had that little bit of extra luxury to get a little further out on the management limb, if you will, and try to get the best deal for the Government. The savings were substantial. Senator Glenn will remember.

Chairman GLENN. Very well.

Senator ROTH. Thank you, Mr. Helm. Thank you, Mr. Chairman.

Chairman GLENN. Thank you very much. We appreciate you sticking with us this morning. It has been a long hearing, but I think it has been a very informative one for us also this morning. We appreciate your testimony and the others that were here earlier.

We have a statement that has been submitted for the record from James L. Blum, Acting Director, Congressional Budget Office and without objection, it will be included in the record.¹

The Committee will stand in recess, subject to the call of the Chair.

[Whereupon, at 12:40 p.m., the Committee was adjourned, subject to the call of the Chair.]

¹ See p. 180.

APPENDIX

Senator Wendell H. Ford
Testimony before the Committee on Governmental Affairs
June 7, 1988
The Biennial Budget Act of 1988

MR. CHAIRMAN: Let me first thank you for scheduling this hearing on budget reform. As you know, since 1981 I have been pushing the idea of moving the federal budget to a 2-year cycle, and it looks like this idea's time has finally come. In his budget message this year, President Reagan called on the Congress to adopt biennial budgeting. The U.S. Chamber of Commerce has endorsed the idea. And just last week, at hearings before the National Economic Commission, there was uniform support expressed for moving to a 2-year budget as a procedural change which would assist Congress in our efforts to address the budget deficit.

I am particularly pleased to appear before this committee today to discuss legislation which Senator Roth, Senator Kassebaum, and I will be introducing later today: The Biennial Budget Act of 1988. This legislation is a melding of Senator Roth's legislation and my earlier 2-year budget bill, and reflects the changes that have been made in the budget process in recent years. I would like to commend my colleague, Senator Roth, for suggesting that we develop this bipartisan bill. His expertise and long-standing interest in a 2-year budget process is an asset to this committee and the Senate, and it is my privilege to coauthor this legislation with him. It is our hope that this bill can become the vehicle for discussion and reform and that the committee will be able to consider our proposal yet this year.

I have provided to you and your staff a detailed summary and section-by-section analysis of our proposal, which I ask be made part of the record along with the text of the bill.

First, let me point out that this is not an anti-Gramm-Rudman-Hollings bill. All the discipline of Gramm-Rudman-Hollings is left in place. The major changes made to the Budget Act by Gramm-Rudman-Hollings, such as the change from a two-resolution system to a one-resolution system, are retained.

Second, enactment of one budget resolution, appropriations covering 2 consecutive fiscal years, and reconciliation are all completed in the first session of each Congress. The second session of each Congress will be devoted to authorizing, oversight, and compliance review.

Containing all the major budget and appropriations decisions in one session will give Congress, and executive agencies, the time to conduct the oversight and compliance review necessary to make informed budgetary decisions. This is a change from my original bill, which, you will recall, spread the budget process out over both sessions. This change reflects the changes made by Gramm-Rudman-Hollings from a two resolution system to a one resolution system. While a two resolution system has a lot to be said for it as a more rational process, the institution made a decision in 1985 to go to a one resolution system, and I am not going to propose going back on that decision.

While there is a risk of rushing to judgment with binding decisions too early in the year, our experiment with 2-year budgeting in the budget summit agreement last year has shown that it can work. Alice Rivlin, former Director of the Congressional Budget Office and currently at the Brookings Institution, noted in her testimony before the National Economic Commission just last week that even though economic forecasting would be less reliable for two years than for one, unforeseen developments can still be considered as they are now. The current budget process provides for supplemental appropriations action, and if Congress must waive the Budget Act to provide spending for emergencies, a biennial budget will not prevent that. As Dr. Rivlin pointed out, the gains in time produced by a biennial process, and the improved spending decisions which result from a 2-year process, outweigh its disadvantages. Recognizing that Congress will most likely need additional time to consider the reconciliation measure affecting two fiscal years, we also increase the number of hours of debate for a reconciliation measure from the current 20 hours to 100 hours.

We have also provided that all budgetary and appropriations actions are completed in the first rather than the second session. Here again, a more purely rational approach might have said to authorize first, that is, in the first session, and then appropriate in the second. That would have kept both authorizing and appropriating actions in the same Congress. But that would also have meant that a newly elected Congress and a newly elected President would have to wait a full year before they could start to work their will on the budget. Even though building that kind of learning period into the process has its desirable aspects, we concluded that it was unrealistic and opted for budgeting in the first session.

It may also be that in fine-tuning this proposal Congress will opt to enact biennial authorizations in the first session of the Congress, concurrent with the budget and appropriations actions. It is my understanding that this is the approach that the Armed Services Committee has taken, under the leadership of Senator Nunn, which has generally moved the defense authorization to a two-year

cycle. Our concern was that Congress have the best possible information base for developing the biennial budget, and it made more sense to require that authorizations be completed prior to submission of the President's budget. However, it may be necessary to build into the system enough flexibility for responses to initiatives proposed by the President in his budget message.

Let me also point out that we purposely did not include a formal procedure in the second session of Congress for enacting changes in the second year of the biennium. To do so would be admitting defeat from the start and forcing on Congress a process which would just lead back to annual budgeting and appropriations. Because we leave the Gramm-Rudman-Hollings process in place, Congress will have a procedure for ensuring that the deficit, and consequently spending, does not exceed the allowable targets. Should Congress find that it must create new programs in the non-budgetary year, we will be able to use our normal supplemental appropriations process to address those unforeseeable issues.

Third, the bill provides for permanent continuing appropriations in the event that Congress and the White House do not complete action on all individual appropriations bills before the beginning of the biennium. Programs funded in the previous biennium will continue to be funded at the same rate of operations, and will be superceded by the enactment of the regular appropriation bills, as is currently the case. The permanent continuing appropriations authority is limited to one biennium period.

Congress has been justly criticized in recent years for using the catch-all continuing appropriations approach to funding. Our inability to enact the budget resolution and thirteen individual appropriation bills on time each year will be aided by a 2-year budget process. The permanent continuing appropriations provision removes the incentive, for both Congress and the White House, to sandbag individual appropriation bills in the hopes of enacting controversial items in the continuing resolution. This provision will also aid state and local governments and recipients of federal funding who often are caught at the end of the fiscal year with threatened lapses in funding. It also eliminates the very time-consuming process of enacting a continuing resolution, and removes the ability to fill a veto-proof continuing resolution with spending programs that bust the budget.

Fourth, the bill contains some features of my original bill, which were in turn carried over from the bills put forward as alternatives to "sunset" bills sponsored several years ago by former Budget Committee Chairman Muskie. The general theme of these features is to strengthen the ability

of committees to obtain information about the operation and effectiveness of a Federal program.

Another change retained from those bills is a requirement that there be consistency in the way budgetary information is presented by all the participants in the process. Budget-related bills, resolutions, and reports must include, or be accompanied by, tables setting forth the budget information at the account level, using uniform accounts. Actions of the Budget Committee are included in this requirement, as they currently have access to account-level detail to back up the function totals. This uniformity will allow efficient tracking and comparison of spending decisions. By using uniform account totals, a program could be tracked through the entire legislative process to determine what the President recommended, what CBO estimated was necessary, what the authorizing committee thought should be provided, what the Budget Committee assumed in its resolution, how much the committee with spending jurisdiction allocated, how much was recommended for appropriation, and how much was finally appropriated.

Finally, with optimism that this proposal can be enacted this year, we provide that this process take effect in the next Congress. FY 89 would be a transition year of single-year appropriations, and would also serve as the initial authorizing period for the biennium which would begin on October 1, 1989. Federal programs must be authorized for at least the two-year period covered by the fiscal biennium. While many federal programs are already multi-year authorizations, many programs will expire in the second year of the biennial budget enacted in the 101st Congress. Therefore, 1989 will be a transition year in which authorizing committees must ensure that programs within their jurisdiction are authorized at least through the biennium ending September 30, 1991. By enacting this proposal this year, we give the new Administration advance notice of the new process, and take advantage of the changing leadership in Congressional committees to smooth the transition to reform.

I want to mention a couple of things that the bill does not do. First, we did not tackle the problem of the 302(b) allocations not adding up to function subtotals in the budget resolution. And we have not touched on any of the committee reorganization proposals that have been introduced. This does not mean that we are opposed to dealing with these issues. It is just that we recognize that there is less agreement on these other proposals, and perhaps not enough time this year to enact all of the other structural changes. There is considerable support for biennial budgeting, and we did not want to diminish the prospects for enactment this year by adding proposals that seem to us to be not quite as ripe for decision at this time.

Biennial budgeting is not a panacea for our federal budgetary problems. But it is a tool which can make the federal government operate more efficiently and allow Congress the time to make considered and informed budgetary decisions. Biennial budgeting will provide greater funding stability and certainty for our elected counterparts in state and local governments and for the numerous beneficiaries of federal funds.

The budget summit last year gave us an opportunity to "get our feet wet" with 2-year budgeting, and the success thus far of that exercise indicates that it is time to take the plunge. Our legislation is a bipartisan approach to biennial budgeting. We are committed to working with our colleagues, and this committee and the Budget Committee, to produce a workable biennial budget bill.

I appreciate the opportunity to testify this morning. I will be pleased to answer any questions, or accept the names of cosponsors.

THE BIENNIAL BUDGET ACT OF 1988

SUMMARY AND SECTION BY SECTION ANALYSIS

Summary

- o Amends the Congressional Budget & Impoundment Control Act of 1974 to provide a 2-year Federal budget cycle.

- o Provides that the first session of each Congress will be devoted to enacting one budget resolution covering a 2-fiscal year period, and appropriations for the 2-fiscal year period. The second session of each Congress will be devoted to authorizing legislation and oversight.

- o The biennial budget period will begin October 1 of each odd-numbered year and will cover the 2 consecutive fiscal years.

- o Provides for a permanent continuing appropriations at the then existing spending levels for those programs for which the regular appropriations bills have not been enacted by the beginning of the 2-year fiscal period.

- o Provides increased authority for the chairmen and ranking members of standing committees to request information, analyses, studies, and other assistance from Federal agencies to assist in the budget formation, appropriations, authorization, and program oversight processes.

- o Effective beginning in the 101st Congress.

Section-by-Section Analysis

Section 1 states the Title of the legislation -- the "Biennial Budget Act of 1988".

Section 2(a) sets forth the findings of the legislation. These are that the Federal budget process allows for insufficient time for (a) the fulfillment by the Congress of its legislative and oversight responsibilities; (b) the review and consideration of authorizing legislation, budget resolutions, and appropriations bills and resolutions and other spending provisions; (c) the evaluation of costly and complicated Federal programs, and thereby contributes to the unrestrained growth of the Federal budget; and (d) for agencies and State and local governments to plan for the implementation of programs.

Section 2(b) sets forth the purposes of the legislation. These are to establish a biennial budget process, to improve congressional control over the budget process, to streamline the budget process, to improve legislative and budget processes by providing additional time for oversight and other vital activities, to provide stability and coherence for recipients of Federal funds and to implement other improvements in the Federal budget process.

Section 3 revises section 300 of the Congressional Budget Act to establish a timetable for the biennial budget cycle, as follows:

First Session

First Monday after January 3.....	President submits budget recommendations.
February 15.....	Congressional Budget Office submits report to Budget Committees.
February 25.....	Committees submit views and estimates to Budget Committees.
March 31.....	Senate Budget Committee reports concurrent resolution on the biennial budget.
April 15.....	Congress completes action on concurrent resolution on the biennial budget.
May 15.....	Biennial appropriation bills may be considered in the House.
June 10.....	House Appropriations Committee reports last biennial appropriation bill.
September 30.....	Congress completes action on reconciliation legislation.

September 30..... Congress completes action
on biennial appropriation
bills.

October 1..... Biennium begins.

Second Session

"On or before
May 15..... Congressional Budget Office
submits report to Budget
Committees.

the last day of the session..... Congress completes action
on bills and resolutions
authorizing new budget
authority for the
succeeding biennium
period.

Section 4(a) amends section 2 of the Budget Act
regarding the purposes of the Budget Act.

Section 4(b) amends section 3 of the Budget Act to
define the "biennium" as a period of 2 fiscal years beginning
October 1 of any odd numbered year.

Section 4(c) makes conforming changes in section 202 of
the Budget Act, regarding the duties and functions of the
Congressional Budget Office.

Section 4(d) amends section 301 of the Budget Act to
change the date for the completion of the budget resolution
to April 15 of each odd-numbered year, to change the date for
the submission of Committees' views to February 25 of each
odd-numbered year, to change the date for the reporting of
the budget resolution to March 31, and to make conforming
changes.

Section 4(e) amends section 302 of the Budget Act to
make 302(b) allocations binding for each year in the
two-fiscal year budget period.

Section 4(f) makes conforming changes in section 303 of
the Budget Act regarding consideration of new budget
authority, changes in revenues, changes in the public debt,
new entitlement authority, and new credit authority to be
effective in a fiscal year for which there is no budget
resolution.

Section 4(g) amends section 304 of the Budget Act regarding revised budget resolutions.

Section 4(h) makes conforming amendment in section 305 of the Budget Act regarding procedures for consideration of the budget resolution.

Section 4(i) amends section 307 of the Budget Act to mandate compliance with deadlines for reporting and consideration of regular appropriation bills. On or before September 30 of each odd-numbered year, the Congress shall complete action on all regular appropriation bills.

Section 4(j) makes conforming amendments in section 308 of the Budget Act regarding reports and summaries of congressional budget action.

Section 4(k) makes conforming amendments in section 309 of the Budget Act regarding House approval of regular appropriation bills.

Section 4(l) amends section 310 of the Budget Act to change the date for completing the reconciliation process to September 30 of each odd-numbered year. Maximum debate on reconciliation is expanded from 20 hours to 100 hours. Specifies that reconciliation should only contain changes in the law with regard to budget matters.

Section 4(m) amends section 311 of the Budget Act to enforce aggregate budgetary levels for each fiscal year in a two-fiscal year period, and to make conforming changes.

Section 4(n) makes conforming changes to section 401 of the Budget Act regarding consideration of new contract and borrowing authority which is not controlled by the appropriations process.

Section 4(o) amends section 403 of the Budget Act to require the Congressional Budget Office to provide estimates for three years following the current fiscal year instead of four.

Section 4(p) adds a new section to Title IV of the Budget Act, section 408. Section 408 requires that Committee reports contain tables which are set forth in the same budget accounts used in the President's budget estimates.

Section 5(a) amends 31 U.S.C. 1101 to define two-fiscal-year budget period.

Section 5(b) amends 31 U.S.C. 1104 to require that the President consult with the Budget, Appropriations, and

Authorizing Committees before making changes in the table of accounts in the budget submission.

Section 5(c) amends 31 U.S.C. 1105 to require the President to submit a two-fiscal-year budget on or before the first Monday after January 3 of each odd-numbered year, and to make conforming changes.

Section 5(d) - 5(g) makes conforming amendments in 31 U.S.C. 1105.

Section 5(h) amends 31 U.S.C. 1105 to require the President's two-fiscal-year period to comply with maximum deficit amounts in Gramm-Rudman for each year.

Section 5(i) amends 31 U.S.C. 1105 and 1106 to require that updated budget submissions for the two-fiscal-year period comply with maximum deficit amounts in Gramm-Rudman for each year.

Section 5(j) amends 31 U.S.C. 1109 to require that the current services budget be submitted at the same time as the President's budget submitted under 31 U.S.C. 1105

Section 5(k) makes conforming changes in 31 U.S.C. 1110 regarding year ahead requests for authorizing legislation.

Section 5(l) makes conforming changes in 31 U.S.C. 1114 regarding budget information and consulting services.

Section 6 amends section 105 of 1 U.S.C. regarding the title and style of appropriation acts.

Section 7 provides increased authority for the chairmen and ranking members of standing committees to request information, analyses, studies, and other assistance from Federal agencies to assist in the budget formation, appropriations, authorization, and program oversight processes.

Section 8 makes conforming changes in the Rules of the House of Representatives.

Section 9 amends 31 U.S.C. 13 regarding continuing appropriations. When an appropriation has not been enacted for a new fiscal period prior to October 1, programs will automatically be funded at their previous years' level until a new appropriations bill has been enacted. This shall be effective beginning after September 30, 1990.

Section 10 sets out the effective dates of the Act. Generally, the provisions of the Act are effective January 1, 1988, with respect to the two-fiscal-year period beginning on October 1, 1989. The current authorizing, budget, and appropriations processes will continue to operate for fiscal year 1989.

FORD-ROTH BIENNIAL BUDGET BILL
Draft—May 27, 1988

100TH CONGRESS
 2D SESSION

S. _____

IN THE SENATE OF THE UNITED STATES

and Mrs. Kassebaum

Mr. FORD (for himself ~~and~~ Mr. ROTH) introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To provide for a 2-year Federal budget cycle, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
 2 *tives of the United States of America in Congress assem-*
 3 *bled,*

4 SECTION 1. SHORT TITLE.

5 This Act may be cited as the "Biennial Budget Act of
 6 1988".

1 SEC. 2. FINDINGS AND PURPOSE.

2 (a) FINDINGS.—The Congress finds and declares that
3 the present annual Federal budgeting process—

4 (1) allows insufficient time for the fulfillment
5 by the Congress of its legislative and oversight
6 responsibilities;

7 (2) allows insufficient time for the review and
8 consideration by the Congress of authorizing legisla-
9 tion, budget resolutions, and appropriation bills and
10 resolutions and other spending measures;

11 (3) allows insufficient time for the evaluation of
12 costly and complicated Federal programs, and there-
13 by contributes to the unrestrained growth of ~~the~~ Fed-
14 eral budget; and

15 (4) allows insufficient time for agencies and
16 State and local governments to plan for the imple-
17 mentation of programs.

18 (b) PURPOSE.—It is the purpose of this Act—

19 (1) to establish a process through which the
20 Federal budget will be adopted for a two-year
21 period;

22 (2) to improve congressional control over the
23 Federal budget process;

24 (3) to streamline the requirements of the budget
25 process in order to promote better accountability to
26 the public;

- 1 (4) to improve the legislative and budgetary
 2 processes by providing additional time for congress-
 3 sional oversight and other vital legislative activities;
 4 (5) to provide stability and coherence for recipi-
 5 ents of Federal funds; and
 6 (6) to implement other improvements in the
 7 Federal budget process.

8 SEC. 3. REVISION OF TIMETABLE.

9 Section 300 of the Congressional Budget Act of 1974
 10 (2 U.S.C. 631) is amended to read as follows:

11 "TIMETABLE

12 "SEC. 300. The timetable with respect to the Congres-
 13 sional budget process for any Congress (beginning with
 14 the One-hundred-and-first Congress) is as follows:

"First Session

First Monday after January 3	President submits budget recommendations.
February 15	Congressional Budget Office submits report to Budget Committees.
February 25	Committees submit views and estimates to Budget Committees.
March 31	Senate Budget Committee reports concurrent resolution on the biennial budget.
April 15	Congress completes action on concurrent resolution on the biennial budget.
May 15	Biennial appropriation bills may be considered in the House.
June 10	House Appropriations Committee reports last biennial appropriation bill.
September 30	Congress completes action on reconciliation legislation.
September 30	Congress completes action on biennial appropriation bills.
October 1	Biennium begins.

"Second Session

"On or before	Action to be completed:
May 15	Congressional Budget Office submits report to Budget Committees.
The last day of the session	Congress completes action on bills and resolutions authorizing new budget authority for the succeeding biennium."

1 SEC. 4. AMENDMENTS TO THE CONGRESSIONAL BUDGET AND IM-
 2 POUNDMENT CONTROL ACT OF 1974.

3 (a) DECLARATION OF PURPOSE.—Section 2(2) of the
 4 Congressional Budget and Impoundment Control Act of
 5 1974 (2 U.S.C. 621(2)) is amended by striking "each
 6 year" and inserting in lieu thereof "biennially".

7 (b) DEFINITIONS.—

8 (1) Section 3(4) of such Act (2 U.S.C. 622(4))
 9 is amended by striking "fiscal year" each place it
 10 appears and inserting in lieu thereof "biennium".

11 (2) Section 3 of such Act (2 U.S.C. 622) is fur-
 12 ther amended by adding at the end thereof the fol-
 13 lowing new paragraph:

14 "(11) The term 'biennium' means the period of
 15 2 consecutive fiscal years beginning on October 1 of
 16 any odd-numbered year."

17 (c) DUTIES OF CBO.—

1 (1) Section 202(f)(1) of the Congressional
2 Budget Act of 1974 (2 U.S.C. 602(f)(1)) is
3 amended—

4 (A) by striking “February 15 of each
5 year” and inserting in lieu thereof “February
6 15 of each odd-numbered calendar year”;

7 (B) by striking “the fiscal year commenc-
8 ing” and inserting in lieu thereof “each fiscal
9 year in the biennium commencing”;

10 (C) by striking “such fiscal year” the first
11 place it appears and inserting in lieu thereof
12 “such biennium”; and

13 (D) by striking “such fiscal year” the
14 second place it appears and inserting in lieu
15 thereof “each fiscal year in such biennium”.

16 (2) Section 202(f) of such Act (2 U.S.C. 602(f))
17 is further amended—

18 (A) in paragraph (2) by striking “The Di-
19 rector shall from time to time” and inserting in
20 lieu thereof “On May 15 of each even num-
21 bered year and at such other times as he or she
22 deems appropriate, the Director shall”.

23 (B) in paragraph (3)—

24 (i) by striking “January 15” and in-
25 serting in lieu thereof “February 15”,

6

1 (ii) by striking "each year" and in-
2 serting in lieu thereof "each even-num-
3 bered calendar year",

4 (iii) by striking "the fiscal year
5 ending September 30 of that calendar
6 year" in clause (A) and inserting in lieu
7 thereof "either fiscal year in the biennium
8 beginning October 1 of the preceding cal-
9 endar year",

10 (iv) by striking "the fiscal year
11 ending September 30 of that calendar
12 year" in clause (B) and inserting in lieu
13 thereof "either fiscal year of such bienni-
14 um", and

15 (v) by striking "fiscal year beginning
16 October 1 of that calendar year" and in-
17 serting in lieu thereof "succeeding bienni-
18 um".

19 (d) BIENNIAL CONCURRENT RESOLUTION ON THE
20 BUDGET.—

21 (1) Section 301(a) of such Act (2 U.S.C.
22 632(a)) is amended—

23 (A) by striking "April 15 of each year"
24 and inserting in lieu thereof "March 31 of each
25 odd-numbered year";

1 (B) by striking "the fiscal year beginning
2 on October 1 of such year" the first place it ap-
3 pears and inserting in lieu thereof "biennium
4 beginning on October 1 of such year";

5 (C) by striking "the fiscal year beginning
6 on October 1 of such year" the second place it
7 appears and inserting in lieu thereof "each
8 fiscal year in such period"; and

9 (D) by striking "each of the two ensuing
10 fiscal years" and inserting in lieu thereof "each
11 fiscal year in the succeeding biennium".

12 (2) Section 301(b) of such Act (2 U.S.C.
13 632(b)) is amended—

14 (A) in the matter preceding paragraph (1)
15 by inserting "for a biennium" after "concur-
16 rent resolution on the budget"; and

17 (B) in paragraph (3) by striking "for such
18 fiscal year" and inserting in lieu thereof "for
19 either fiscal year in such biennium".

20 (3) Section 301(d) of such Act (2 U.S.C.
21 632(d)) is amended by striking "February 25 of each
22 year" and inserting in lieu thereof "February 25 of
23 each odd-numbered year".

24 (4) Section 301(e) of such Act (2 U.S.C.
25 632(e)) is amended—

1 (A) in the first sentence by striking "fiscal
2 year" and inserting in lieu thereof "biennium";

3 (B) by inserting between the second and
4 third sentences the following new sentence:
5 "On or before ^{March 31} ~~April 1~~ of each odd-numbered
6 year the Committee on the Budget of each
7 House shall report to its House the concurrent
8 resolution on the budget referred to in subsec-
9 tion (a) for the biennium beginning on October
10 1 of that year."; and

11 (C) in paragraph (6)—

12 (i) by striking "five" and inserting in
13 lieu thereof "four",

14 (ii) by striking "such fiscal year" and
15 inserting in lieu thereof "the first fiscal
16 year of such biennium," and

17 (iii) by striking "such period" and in-
18 serting in lieu thereof "such four-fiscal-
19 year period".

20 (5) Section 301(f) of such Act (2 U.S.C. 632(f))
21 is amended by striking "fiscal year" each place it
22 appears and inserting in lieu thereof "biennium".

23 (6) Section 301(i)(1)(A) of such Act (2 U.S.C.
24 632(i)(1)(A)) is amended—

1 (A) by striking "for a fiscal year" and in-
2 serting in lieu thereof "for a biennium"; and

3 (B) by striking "for such fiscal year" the
4 first place it appears and inserting in lieu there-
5 of "for either fiscal year in such biennium".

6 (7) The section heading of section 301 of such
7 Act is amended by striking "ANNUAL" and insert-
8 ing in lieu thereof "BIENNIAL".

9 ~~(8) The table of contents set forth in section~~

10 1(b) of the Congressional Budget and Impoundment
11 Control Act of 1974 is amended by striking
12 "Annual" in the item relating to section 301 and in-
13 serting in lieu thereof "Biennial".

14 (e) COMMITTEE ALLOCATIONS.—

15 (1) Paragraphs (1) and (2) of section 302(a) of
16 such Act (2 U.S.C. 633(a)) are amended—

17 (A) by inserting "for a biennium" after
18 "budget" the first place it appears in each such
19 paragraph; and

20 (B) by inserting "for each fiscal year in
21 such biennium" after "estimated allocation"
22 each place it appears.

23 (2) Section 302(c) of such Act (2 U.S.C.
24 633(c)) is amended—

1 (A) by striking "for a fiscal year" each
2 place it appears and inserting in lieu thereof
3 "for either fiscal year in a biennium"; and

4 (B) by striking "for such fiscal year" each
5 place it appears and inserting in lieu thereof
6 "for such biennium".

7 (3) Section 302(f)(1) of such Act (2 U.S.C.
8 633(f)(1)) is amended—

9 (A) by striking "for a fiscal year" and in-
10 serting in lieu thereof "for a biennium", and

11 (B) by striking "such fiscal year" each
12 place it appears in the matter preceding sub-
13 paragraph (A) and inserting in lieu thereof "a
14 fiscal year in such biennium".

15 (C) Section 302(f)(2) of such Act is
16 amended—

17 (i) by striking "for a fiscal year" and
18 inserting in lieu thereof "for a biennium",
19 and

20 (ii) by striking "for such fiscal year"
21 and inserting in lieu thereof "for a bienni-
22 um".

23 (f) SECTION 303 POINT OF ORDER.—

24 (1) Section 303(a) of such Act (2 U.S.C.
25 634(a)) is amended by striking "fiscal year" each

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1 place it appears and inserting in lieu thereof "bienni-
2 um".

3 (2) Section 303(b) of such Act (2 U.S.C.
4 634(b)) is amended—

5 (A) by striking "fiscal year" each place it
6 appears and inserting in lieu thereof "bienni-
7 um"; and

8 (B) in the matter following paragraph (2)
9 by striking "any calendar year" and inserting
10 in lieu thereof "any odd-numbered calendar
11 year".

12 (g) PERMISSIBLE REVISIONS OF CONCURRENT RESOLU-
13 TIONS ON THE BUDGET.—Section 304 of such Act (2 U.S.C.
14 635) is amended—

15 (1) by striking "fiscal year" the first two places
16 it appears and inserting in lieu thereof "biennium";

17 (2) by striking "for such fiscal year"; and

18 (3) by inserting before the period "for such bi-
19 ennium".

20 (h) PROCEDURES FOR CONSIDERATION OF BUDGET RES-
21 OLUTIONS.—Section 305(b)(3) of such Act (2 U.S.C.
22 636(b)(3)) is amended—

23 (1) striking "the concurrent" and inserting in
24 lieu thereof "a concurrent"; and

1 (2) by striking "fiscal year" and inserting in
2 lieu thereof "biennium".

3 (i) COMMITTEE ACTION ON APPROPRIATION AND OTHER
4 SPENDING BILLS.—

5 (1) Section 307 of such Act (2 U.S.C. 638) is
6 amended to read as follows:

7 "ACTION ON APPROPRIATION BILLS

8 "SEC. 307. (a) HOUSE COMMITTEE ACTION.—On or
9 before June 10 of each odd-numbered calendar year, the
10 Committee on Appropriations of the House of Representa-
11 tives shall report to the House all regular appropriation
12 bills providing new budget authority for the biennium that
13 begins on October 1 of that year.

14 "(b) ACTION BY HOUSE.—On or before June 15 of
15 each odd-numbered calendar year, the House of Represent-
16 atives shall pass all regular appropriation bills providing
17 new budget authority for the biennium that begins on Oc-
18 tober 1 of that year.

19 "(c) SENATE COMMITTEE ACTION.—On or before June
20 30 of each odd-numbered year, the Committee on Appro-
21 priations of the Senate shall report to the Senate all regular
22 appropriation bills providing new budget authority for the
23 biennium that begins on October 1 of that year.

24 "(d) ACTION BY SENATE.—On or before July 31 of
25 each odd-numbered calendar year, the Senate shall pass all

1 regular appropriation bills for the biennium that begins on
2 October 1 of that year.

3 “(e) COMPLETION OF ACTION BY CONGRESS.—On or
4 before September 30 of each odd-numbered calendar year,
5 the Congress shall complete action on all regular appro-
6 priation bills for the biennium beginning on October 1 of
7 that year.”.

8 (2) The item relating to section 307 in the table
9 of contents in section 1(b) of the Congressional
10 Budget and Impoundment Control Act of 1974 is
11 amended to read as follows:

“Sec. 307. Action on appropriation bills.”.

12 (j) REPORTS AND SUMMARIES OF CONGRESSIONAL
13 BUDGET ACTIONS.—

14 (1)(A) Section 308(a)(1) of the Congressional
15 Budget Act of 1974 (2 U.S.C. 639(a)(1)) is amend-
16 ed—

17 (i) in the matter preceding subparagraph
18 (A) by striking “fiscal year” and inserting in
19 lieu thereof “biennium”,

20 (ii) in subparagraph (A) by striking “fiscal
21 year” and inserting in lieu thereof “biennium”,
22 and

23 (iii) in subparagraph (C) by striking “such
24 fiscal year” and inserting in lieu thereof “such
25 biennium”.

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1 (B) Section 308(a)(2) of such Act is amended
2 by striking "fiscal year" and inserting in lieu there-
3 of "biennium".

4 (2) Section 308(b)(1) of such Act (2 U.S.C.
5 639(b)(1)) is amended—

6 (A) by striking "fiscal year" the first place
7 it appears and inserting in lieu thereof "bienni-
8 um";

9 (B) by inserting "for such biennium" after
10 "concurrent resolution on the budget"; and

11 (C) by striking "the fiscal year preceding
12 such fiscal year" and inserting in lieu thereof
13 "each fiscal year in the biennium preceding
14 such biennium".

15 (3) Section 308(c) of such Act (2 U.S.C.
16 639(c)) is amended—

17 (A) by striking "Five" in the subsection
18 heading and inserting in lieu thereof "Four";

19 (B) by striking "fiscal year" each place it
20 appears in the matter preceding paragraph (1)
21 and inserting in lieu thereof "biennium"; and

22 (C) by striking "5 fiscal years" and insert-
23 ing in lieu thereof "4 fiscal years".

1 (k) COMPLETION OF ACTION ON REGULAR APPROPRIA-
2 TION BILLS.—Section 309 of such Act (2 U.S.C. 640) is
3 amended—

4 (1) by inserting “of any odd-numbered calendar
5 year” after “July”;

6 (2) by striking “annual” and inserting in lieu
7 thereof “regular”; and

8 (3) by striking “fiscal year” and inserting in
9 lieu thereof “biennium”.

10 (l) RECONCILIATION PROCESS.—

11 (1) Section 310(a) of such Act (2 U.S.C.
12 641(a)) is amended—

13 (A) by striking “any fiscal year” in the
14 matter preceding paragraph (1) and inserting in
15 lieu thereof “any biennium”;

16 (B) in paragraph (1) by striking “such
17 fiscal year” each place it appears and inserting
18 in lieu thereof “each fiscal year in such bienni-
19 um”; and

20 (C) in paragraph (2) by inserting “for each
21 fiscal year in such biennium” after “revenues”.

22 (2) Section 310(e) of such Act (2 U.S.C.
23 641(e)) is amended—

1 (A) by striking "20 hours" in paragraph
2 (2) and inserting in lieu thereof "100 hours";
3 and

4 (B) by adding at the end thereof the fol-
5 lowing new paragraph:

6 "(3) It shall not be in order in the Senate or the
7 House of Representatives to consider any reconcilia-
8 tion bill or resolution or any amendment thereto or
9 any conference report thereon which changes any
10 provision of law other than provisions of law
11 which—

12 "(A) provide new budget authority or
13 spending authority described in section
14 401(c)(2)(C);

15 "(B) relate to revenues; or

16 "(C) specify the amount of the statutory
17 limit on the public debt."

18 (3) Section 310(f) of such Act (2 U.S.C. 641(f))
19 is amended—

20 (A) in paragraph (1)—

21 (i) by inserting "for a biennium"
22 after "subsection (b)", and

23 (ii) by striking "June 15 of each
24 year" and inserting in lieu thereof "Sep-

1 tember 30 of the calendar year in which
2 the biennium begins"; and

3 (B) in paragraph (2)—

4 (i) by inserting "of any odd-numbered
5 calendar year" after "July",

6 (ii) by striking "fiscal year beginning
7 on October 1 of the calendar year to which
8 the adjournment resolution pertains" and
9 inserting in lieu thereof "biennium begin-
10 ning on October 1 of such calendar year",
11 and

12 (iii) by striking "for such fiscal year"
13 and inserting in lieu thereof "for such bi-
14 ennium".

15 (m) SECTION 311 POINT OF ORDER.—

16 (1) Section 311(a) of such Act (2 U.S.C.
17 642(a)) is amended—

18 (A) by striking "for a fiscal year" and in-
19 serting in lieu thereof "for a biennium";

20 (B) by striking "such fiscal year" the first,
21 second, and third places it appears and inserting
22 in lieu thereof "a fiscal year in such bienni-
23 um";

24 (C) by inserting "for such fiscal year"
25 after "outlays";

1 (D) by striking "concurrent resolution on
2 the budget for such fiscal year" and inserting in
3 lieu thereof "concurrent resolution on the
4 budget for the biennium in which such fiscal
5 year occurs";

6 (E) by inserting "for such fiscal year"
7 after "revenues" the first place it appears; and

8 (F) by inserting "for such fiscal year"
9 after "set forth" the second place it appears.

10 (2) Section 311(b) of such Act (2 U.S.C.
11 642(b)) is amended—

12 (A) by striking "such fiscal year" the first
13 place it appears and inserting in lieu thereof "a
14 biennium"; and

15 (B) by striking "such fiscal year" the
16 second place it appears and inserting in lieu
17 thereof "either fiscal year in such biennium".

18 (n) BILLS PROVIDING NEW SPENDING AUTHORITY.—
19 Section 401(b)(2) of such Act (2 U.S.C. 651(b)(2)) is
20 amended by striking "for such fiscal year" the second
21 place it appears and inserting in lieu thereof "for the bien-
22 nium in which such fiscal year occurs".

23 (o) ANALYSIS BY CBO.—Section 403(a) of the Con-
24 gressional Budget Act of 1974 (2 U.S.C. 653(a)) is
25 amended—

1 (1) by striking "the fiscal year" in paragraph
2 (1) and inserting in lieu thereof "each fiscal year in
3 the biennium";

4 (2) by striking "4 fiscal years following such
5 year" in paragraph (1) and inserting in lieu thereof
6 "each fiscal year in the succeeding biennium";

7 (3) by striking "the fiscal year" in paragraph
8 (2) and inserting in lieu thereof "each fiscal year in
9 the biennium"; and

10 (4) by striking "four fiscal years following such
11 fiscal year" in paragraph (2) and inserting in lieu
12 thereof "each fiscal year in the succeeding bienni-
13 um".

14 (p) IMPROVED FISCAL PROCEDURES.—

15 (1) Title IV of such Act (2 U.S.C. 651 et seq.)
16 is amended by adding at the end thereof the follow-
17 ing new sections:

18 "REPORTS

19 "SEC. 408. (a)(1) The reports required by sections
20 301(d), 302(b), 308(b), and 308(c) shall contain the tables
21 described in subsection (b).

22 "(2) Any—

23 "(A) concurrent resolution on the budget re-
24 ported by the Committee on the Budget of the
25 Senate or the House of Representatives under section
26 301 or 304 of this Act; and

1 “(B) bill or resolution reported by a committee
2 of the Senate or the House of Representatives which
3 provides, modifies, or terminates budget authority or
4 spending authority described in section 401(c)(2)(C),
5 or which contains or modifies estimates of budget
6 outlays,
7 shall be accompanied by a report containing the tables de-
8 scribed in subsection (b). The conference report on any bill
9 or resolution described in clause (A) or (B) of the preced-
10 ing sentence shall be accompanied by a joint statement of
11 the managers containing such tables.

12 “(b)(1) The tables required by subsection (a) shall set
13 forth estimates of budget authority, spending authority de-
14 scribed in section 401(c)(2)(C), and budget outlays for
15 each of the accounts (to which the report, bill, or resolu-
16 tion referred to in such subsection pertains) which are set
17 forth in the table of appropriation and fund accounts con-
18 tained in the Budget of the United States Government sub-
19 mitted by the President pursuant to subsection (a) of sec-
20 tion 1105 of title 31, United States Code, during the Con-
21 gress in which the report referred to in subsection (a)(1) is
22 made or the bill or resolution described in subsection
23 (a)(2) is reported. If any such report, Bill, or resolution
24 contains provisions involving budget authority, spending
25 authority, or outlays for which accounts have not been in-

1 cluded in such table, the estimates therefor in the table
2 required by this subsection shall be set forth in account
3 records with account identification codes assigned by the
4 Director of the Congressional Budget Office.

5 “(2) The tables described in paragraph (1) which are
6 required to be included in the reports required by sections
7 301(d), 302(b), 308(b), and 308(c), and in the reports ac-
8 companying any concurrent resolution on the budget re-
9 ported under section 301 or 304 shall also set forth esti-
10 mates for the budget authority and spending authority de-
11 scribed in section 401(c)(2)(C) which will become avail-
12 able without further congressional action and estimates of
13 the outlays that will result from such budget authority and
14 spending authority.

15 SEC. 5. AMENDMENTS TO TITLE 31, UNITED STATES CODE.

16 (a) DEFINITION.—Section 1101 of title 31, United
17 States Code, is amended by adding at the end thereof the
18 following new paragraph:

19 “(3) ‘biennium’ has the meaning given to such
20 term in paragraph (11) of section 3 of the Congres-
21 sional Budget and Impoundment Control Act of
22 1974 (2 U.S.C. 622(11))”.

23 (b) BUDGET AND APPROPRIATIONS AUTHORITY OF THE
24 PRESIDENT.—Section 1104(c) of title 31, United States
25 Code, is amended—

1 (1) by inserting "(1)" and "(c)";

2 (2) by striking the second sentence thereof; and

3 (3) by adding at the end thereof the following

4 new paragraph:

5 "(2) The budget submitted pursuant to section 1105
6 for the biennium beginning on October 1, 1989, shall be
7 set forth in the same accounts which are set forth in the
8 table entitled 'The Federal Program by Agency and Ac-
9 count' contained in the budget submitted for fiscal year
10 1989 under section 1105. Any change in the table of ac-
11 counts used in the budget submitted under section 1105 for
12 the biennium beginning on October 1, 1989, from the table
13 of accounts set forth in such table contained in the budget
14 submitted under section 1105 for fiscal year 1989, and any
15 change in the table of accounts used in the budget submit-
16 ted under section 1105 for any succeeding biennium from
17 the table used in the budget submitted for the previous bi-
18 ennium shall be made only in consultation with the Com-
19 mittees on Appropriations, the Committees on the Budget,
20 and the committees having legislative jurisdiction over the
21 programs or activities which will be affected by such
22 changes. The provisions of this paragraph do not prohibit
23 the inclusion of proposed new accounts in such table
24 solely for purposes of presenting estimates for proposed
25 new programs."

1 (c) BUDGET CONTENTS AND SUBMISSION TO THE CON-
2 GRESS.—

3 (1) So much of section 1105(a) of title 31,
4 United States Code, as precedes paragraph (1) there-
5 of is amended to read as follows:

6 “(a) On or before the first Monday after January 3 of
7 each odd-numbered year, beginning with the one-hundred-
8 and-first Congress, the President shall transmit to the Con-
9 gress, the budget for the biennium beginning on October 1
10 of such calendar year. The budget transmitted under this
11 subsection shall include the President’s Budget Message,
12 summary data and text, and supporting detail. The budget
13 shall set forth in such form and detail as the President may
14 determine—”.

15 (2) Section 1105(a)(5) of title 31, United States
16 Code, is amended by striking “the fiscal year for
17 which the budget is submitted and the 4 fiscal years
18 after that year” and inserting in lieu thereof “each
19 fiscal year in the biennium for which the budget is
20 submitted and in the succeeding biennium”.

21 (3) Section 1105(a)(6) of title 31, United States
22 Code, is amended by striking “the fiscal year for
23 which the budget is submitted and the 4 fiscal years
24 after that year” and inserting in lieu thereof “each

1 fiscal year in the biennium for which the budget is
2 submitted and in the succeeding biennium”.

3 (4) Section 1105(a)(9)(C) of title 31, United
4 States Code, is amended by striking “the fiscal
5 year” and inserting in lieu thereof “each fiscal year
6 in the biennium”.

7 (5) Section 1105(a)(12) of title 31, United
8 States Code, is amended—

9 (A) by striking “the fiscal year” in sub-
10 paragraph (A) and inserting in lieu thereof
11 “each fiscal year in the biennium”; and

12 (B) by striking “after that year” in sub-
13 paragraph (B) and inserting in lieu thereof “im-
14 mediately following the second fiscal year in
15 such biennium”.

16 (6) Section 1105(a)(13) of title 31, United
17 States Code, is amended by striking “the fiscal
18 year” and inserting in lieu thereof “each fiscal year
19 in the biennium”.

20 (7) Section 1105(a)(14) of title 31, United
21 States Code, is amended by striking “that year” and
22 inserting in lieu thereof “each fiscal year in the bi-
23 ennium for which the budget is submitted”.

24 (8) Section 1105(a)(16) of title 31, United
25 States Code, is amended by striking “the fiscal

1 year'' and inserting in lieu thereof ''each fiscal year
2 in the biennium''.

3 (9) Section 1105(a)(17) of title 31, United
4 States Code, is amended—

5 (A) by striking ''the fiscal year following
6 the fiscal year'' and inserting in lieu thereof
7 ''each fiscal year in the biennium following the
8 biennium'';

9 (B) by striking ''that following fiscal
10 year'' and inserting in lieu thereof ''each such
11 fiscal year''; and

12 (C) by striking ''fiscal year before the
13 fiscal year'' and inserting in lieu thereof ''bien-
14 nium before the biennium''.

15 (10) Section 1105(a)(18) of title 31, United
16 States Code, is amended—

17 (A) by striking ''the prior fiscal year'' and
18 inserting in lieu thereof ''each of the 2 most re-
19 cently completed fiscal years'';

20 (B) by striking ''for that year'' and insert-
21 ing in lieu thereof ''with respect to that fiscal
22 year''; and

23 (C) by striking ''in that year'' and insert-
24 ing in lieu thereof ''in that fiscal year''.

1 (11) Section 1105(a)(19) of title 31, United
2 States Code, is amended—

3 (A) by striking “the prior fiscal year” and
4 inserting in lieu thereof “each of the 2 most re-
5 cently completed fiscal years”;

6 (B) by striking “for that year” and insert-
7 ing in lieu thereof “with respect to that fiscal
8 year”; and

9 (C) by striking “in that year” each place it
10 appears and inserting in lieu thereof “in that
11 fiscal year”.

12 (d) ESTIMATED EXPENDITURES OF LEGISLATIVE AND JU-
13 DICIAL BRANCHES.—Section 1105(b) of title 31, United
14 States Code, is amended by striking “each year” and in-
15 serting in lieu thereof “each even-numbered year”.

16 (e) RECOMMENDATIONS TO MEET ESTIMATED DEFICIEN-
17 CIES.—Section 1105(c) of title 31, United States Code, is
18 amended—

19 (1) by striking “fiscal year for” each place it
20 appears and inserting in lieu thereof “biennium
21 for”;

22 (2) by inserting “or current biennium, as the
23 case may be,” after “current fiscal year”; and

24 (3) by striking “that year” and inserting in lieu
25 thereof “that period”.

1 (f) STATEMENT WITH RESPECT TO CERTAIN
2 CHANGES.—Section 1105(d) of title 31, United States
3 Code, is amended by striking “fiscal year” and inserting
4 in lieu thereof “biennium”.

5 (g) CAPITAL INVESTMENT ANALYSIS.—Section 1105(e)
6 of title 31, United States Code, is amended by striking
7 “ensuing fiscal year” and inserting in lieu thereof “bien-
8 nium to which such budget relates”.

9 (h) COMPLIANCE WITH MAXIMUM DEFICIT AMOUNT.—
10 Section 1105(f) of title 31, United States Code, is
11 amended—

12 (1) in paragraph (1)—

13 (A) by striking “a fiscal year” and insert-
14 ing in lieu thereof “a biennium”, and

15 (B) by striking “such fiscal year” the first
16 place it appears and inserting in lieu thereof
17 “each fiscal year in such biennium”; and

18 (2) in paragraph (2) by striking “in the budget
19 so transmitted for any fiscal year” and inserting in
20 lieu thereof “for a fiscal year in a budget transmitted
21 pursuant to subsection (a)”.

22 (i) SUPPLEMENTAL BUDGET ESTIMATES AND
23 CHANGES.—

24 (1) Section 1106(a) of title 31, United States
25 Code, is amended—

1 (A) in the matter preceding paragraph (1)
2 by striking "fiscal year" and inserting in lieu
3 thereof "biennium";

4 (B) in paragraph (1) by striking "that
5 fiscal year" and inserting in lieu thereof "each
6 fiscal year in such biennium";

7 (C) in paragraph (2) by striking "following
8 the fiscal year" and inserting in lieu thereof
9 "following the biennium";

10 (D) by striking "future fiscal years" in
11 paragraph (3) and inserting in lieu thereof "the
12 2 fiscal years following the biennium for which
13 the budget is submitted"; and

14 (E) by striking "fiscal year" the last place
15 it appears in paragraph (3) and inserting in lieu
16 thereof "biennium".

17 (2) Section 1106(b) of title 31, United States
18 Code, is amended by striking "the fiscal year" and
19 inserting in lieu thereof "each fiscal year in the bi-
20 ennium".

21 (j) CURRENT PROGRAMS AND ACTIVITIES ESTIMATES.—

22 (1) Section 1109(a) of title 31, United States
23 Code, is amended—

24 (A) by striking "Before November 11 of
25 each year," and inserting in lieu thereof "At

1 the same time the budget required by section
2 1105 is submitted for a biennium"; and

3 (B) by striking "the following fiscal year"
4 and inserting in lieu thereof "each fiscal year of
5 such period".

6 (2) Section 1109(b) of title 31, United States
7 Code, is amended by striking "~~January~~^{March 1} of each
8 year" and inserting in lieu thereof "February 25 of
9 each odd-numbered year".

10 (k) YEAR-AHEAD REQUESTS FOR AUTHORIZING LEGIS-
11 LATION.—Section 1110 of title 31, United States Code, is
12 amended—

13 (1) by striking "fiscal year" and inserting in
14 lieu thereof "biennium (beginning on or after Octo-
15 ber 1, 1989)", and

16 (2) by striking "year before the year in which
17 the fiscal year begins" and inserting "second calen-
18 dar year preceding the calendar year in which the bi-
19 ennium begins".

20 (l) BUDGET INFORMATION ON CONSULTING SERVICES.—
21 Section 1114 of title 31, United States Code, is amended—

22 (1) by striking "The" each place it appears and
23 inserting in lieu thereof "For each biennium begin-
24 ning with the biennium beginning on October 1,
25 1989, the"; and

1 (2) by striking "each year" each place it
2 appears.

3 SEC. 6. TITLE AND STYLE OF APPROPRIATIONS ACTS.

4 Section 105 of title 1, United States Code, is amended
5 to read as follows: -

6 "§ 105. Title and style of appropriation Acts

7 "(a) The style and title of all Acts making appropria-
8 tions for the support of the Government shall be as fol-
9 lows: 'An Act making appropriations (here insert the
10 object) for the biennium ending September 30 (here insert
11 the odd-numbered calendar year.).'.

12 "(b) All Acts making regular appropriations for the
13 support of the Government shall be enacted for a biennium
14 and shall specify the amount of appropriations provided
15 for each fiscal year in such period.

16 "(c) For purposes of this section, the term 'biennium'
17 has the same meaning as in section 3(11) of the Congres-
18 sional Budget and Impoundment Control Act of 1974 (2
19 U.S.C. 622(11)).".

20 SEC. 7. ASSISTANCE BY FEDERAL AGENCIES TO STANDING COM-
21 MITTEES OF THE SENATE AND THE HOUSE OF
22 REPRESENTATIVES.

23 (a) INFORMATION REGARDING AGENCY APPROPRIATIONS
24 REQUESTS.—To assist each standing committee of the
25 Senate and the House of Representatives in carrying out its

1 responsibilities, the head of each Federal agency which ad-
2 ministers the laws or parts of laws under the jurisdiction of
3 such committee shall provide to such committee such stud-
4 ies, information, analyses, reports, and assistance, includ-
5 ing the requests for appropriations and the justifications
6 therefor submitted by the agency to the President pursuant
7 to section 1108 of title 31, United States Code, as may be
8 requested by the chairman and ranking minority member
9 of the committee, except that such requests and justifica-
10 tions for a biennium shall not be submitted under this sub-
11 section until after the day the President transmits the
12 Budget to the Congress under section 1105 of such title for
13 such period.

14 (b) INFORMATION REGARDING AGENCY PROGRAM AD-
15 MINISTRATION.—

16 (1) FURNISHING INFORMATION.—To assist each
17 standing committee of the Senate and the House of
18 Representatives in carrying out its responsibilities,
19 the head of any agency shall furnish without charge
20 to such committee computer tapes or disks, together
21 with explanatory documentation, containing informa-
22 tion received, compiled, or maintained by the agency
23 as part of the operation or administration of a pro-
24 gram, or specifically compiled pursuant to a request
25 in support of a review of a program, as may be re-

1 requested by the chairman and ranking minority
2 member of such committee.

3 (2) MINIMIZING REQUESTS.—The Committee on
4 House Administration of the House of Representa-
5 tives and the Committee on Rules and Administra-
6 tion of the Senate shall prescribe rules and regula-
7 tions for their respective Houses which will mini-
8 mize duplication of requests under paragraph (1) of
9 this subsection.

10 (c) SUMMARIES BY COMPTROLLER GENERAL.—Within
11 30 days after the receipt of a request from a chairman and
12 ranking minority member of a standing committee having
13 jurisdiction over a program being reviewed and studied by
14 such committee under this section, the Comptroller Gener-
15 al of the United States shall furnish to such committee
16 summaries of any audits or reviews of such program which
17 the Comptroller General has completed during the preced-
18 ing 6 years.

19 (d) CONGRESSIONAL ASSISTANCE.—Consistent with
20 their duties and functions under law, the Comptroller Gen-
21 eral of the United States, the Director of the Congressional
22 Budget Office, the Director of the Office of Technology
23 Assessment, and the Director of the Congressional Re-
24 search Service shall furnish to each standing committee of
25 the Senate or the House of Representatives such informa-

1 tion, studies, analyses, and reports as the chairman and
2 ranking minority member may request to assist the com-
3 mittee in conducting reviews and studies of programs
4 under this section.

5 (e) SECRET AND CLASSIFIED INFORMATION PROTECT-
6 ED.—This section does not require the public disclosure of
7 matters that are specifically authorized under criteria estab-
8 lished by an Executive order to be kept secret in the inter-
9 est of national defense or foreign policy and are in fact
10 properly classified pursuant to such Executive order, or
11 which are otherwise specifically protected by law. This
12 section does not require any committee of the Senate to
13 disclose publicly information the disclosure of which is
14 governed by Senate Resolution 400, Ninety-fourth Con-
15 gress, or any other rule of the Senate.

16 SEC. 8. AMENDMENTS TO RULES OF HOUSE OF REPRESENTA-
17 TIVES.

18 (a) Clause 4(a)(1)(A) of rule X of the Rules of the
19 House of Representatives is amended by inserting "odd-
20 numbered" after "each".

21 (b) Clause 4(a)(2) of rule X of the Rules of the House
22 of Representatives is amended by striking "such fiscal
23 year" and inserting in lieu thereof "the biennium in which
24 such fiscal year begins".

1 (c) Clause 4(b)(2) of rule X of the Rules of the House
2 of Representatives is amended by striking "first concur-
3 rent resolution on the budget for each fiscal year" and in-
4 serting in lieu thereof "concurrent resolution on the budget
5 required under section 301(a) of the Congressional Budget
6 Act of 1974 for each biennium".

7 (d) Clause 4(f) of rule X of the Rules of the House of
8 Representatives is amended by striking "annually" each
9 place it appears and inserting in lieu thereof "biennially".

10 (e) Clause 4(g) of rule X of the Rules of the House of
11 Representatives is amended—

12 (1) by striking "March 15 of each year" and
13 inserting in lieu thereof "March 15 of each odd-
14 numbered year";

15 (2) by striking "fiscal year" the first place it
16 appears and inserting in lieu thereof "biennium";
17 and

18 (3) by striking "that fiscal year" and inserting
19 in lieu thereof "each fiscal year in such ensuing bi-
20 ennium".

21 (f) Clause 4(h) of rule X of the Rules of the House of
22 Representatives is amended by striking "fiscal year" and
23 inserting in lieu thereof "biennium".

24 (g) Subdivision (C) of clause 2(l)(1) of rule XI of the
25 Rules of the House of Representatives is repealed.

1 (h) Clause 4(a) of rule XI of the Rules of the House
2 of Representatives is amended by striking "fiscal year if
3 reported after September 15 preceding the beginning of
4 such fiscal year" and inserting in lieu thereof "biennium
5 if reported after August 1 of the year in which such bienni-
6 um begins".

7 (i) Clause 2 of rule XLIX of the Rules of the House
8 of Representatives is amended by striking "fiscal year"
9 and inserting in lieu thereof "biennium".

10 SEC. 9. CONTINUING APPROPRIATIONS.

11 (a) AMENDMENT TO TITLE 31.—

12 (1) Chapter 13 of title 31, United States Code,
13 is amended by inserting after section 1310 the fol-
14 lowing new section:

15 "§ 1311. Continuing appropriations

16 "(a)(1) Except as provided in paragraph (2), if any of
17 the regular appropriation bills for a biennium does not
18 become law before the beginning of such period, there are
19 hereby appropriated, out of any moneys in the Treasury
20 not otherwise appropriated, and out of applicable corporate
21 or other revenues, receipts, and funds, such sums as may
22 be necessary to continue any project or activity, provided
23 for in a regular appropriation Act that has become effec-
24 tive ~~in accordance with section 1312 of this title~~ for the
25 preceding biennium, at a rate of operations not in excess of

1 the rate of operations provided for such project or activity
2 for such preceding biennium in such Act.

3 “(2) If the rate of operations provided for a project or
4 activity for the second fiscal year in a biennium differs
5 from the rate of operations provided for such project or
6 activity for the first fiscal year in such biennium by reason
7 of reductions made pursuant to an order issued under sec-
8 tion 252 of the Balanced Budget and Emergency Deficit
9 Control Act of 1985, such project or activity shall be con-
10 tinued at a rate of operations not in excess of the rate of
11 operations provided for such project or activity for such
12 second fiscal year.

13 “(b) Amounts appropriated pursuant to subsection (a)
14 with respect to a biennium shall be available for the period
15 beginning with the first day of such period and ending with
16 the earlier of—

17 “(1) the day after the first date on which the
18 regular appropriation bill for the program or activity
19 funded under subsection (a) of this section has
20 become law, or

21 “(2) the last day of such biennium.

22 “(c) For purposes of this section, ‘regular appropria-
23 tion bill’ has the meaning given such term in section 307
24 of the Congressional Budget Act (2 U.S.C. 638).”.

1 (2) The analysis of chapter 13 of title 31,
2 United States Code, is amended by inserting after the
3 item relating to section 1310 the following new item:
 "1311. Continuing appropriations."

4 (b) AMENDMENT TO THE BALANCED BUDGET AND
5 EMERGENCY DEFICIT CONTROL ACT OF 1985.—Section
6 251(a)(6) of the Balanced Budget and Emergency Deficit
7 Control Act of 1985 (2 U.S.C. 901(a)(6)) is amended by
8 adding at the end thereof the following: "For purposes of
9 subparagraph (B), continuing appropriations made pursu-
10 ant to section 1311 of title 31, United States Code, shall be
11 treated as continuing appropriations for an entire fiscal
12 year."

13 (c) EFFECTIVE DATE.—

14 (1) The amendments made by this section shall
15 apply to bienniums beginning after September 30,
16 1991.

17 (2) For purposes of determining the application
18 of section 1311 of title 31, United States Code, to
19 the biennium beginning October 1, 1991, any project
20 or activity provided for in a joint resolution making
21 continuing appropriations for the fiscal year begin-
22 ning October 1, 1990, shall be treated as having been
23 provided for in a regular appropriation Act.

24 (3) For purposes of determining the rate of op-
25 erations for a project or activity under section 1311

1 of title 31, United States Code, for the biennium be-
2 ginning October 1, 1991, the rate of operations for
3 such project or activity in each fiscal year of such
4 biennium shall equal the rate provided for such
5 project or activity in a regular appropriation Act for
6 the fiscal year beginning October 1, 1990 or a joint
7 resolution making continuing appropriations for such
8 fiscal year.

9 SEC. 10. EFFECTIVE DATE; APPLICATION.

10 (a) IN GENERAL.—Except as provided in subsection
11 (b), this Act and the amendments made by this Act shall
12 become effective January 1, 1988, and shall apply to bien-
13 niums beginning after September 30, 1989.

14 (b) FISCAL YEAR 1989.—Notwithstanding subsection
15 (a), the provisions of—

16 (1) the Congressional Budget Act of 1974, and

17 (2) title 31, United States Code,

18 (as such provisions were in effect on the day before the
19 effective date of this Act) shall apply to the fiscal year
20 beginning on October 1, 1988.

21 (c) DEFINITION.—For purposes of this section, the
22 term “biennium” shall have the meaning given to such
23 term in section 3(11) of the Congressional Budget and Im-
24 poundment Control Act of 1974 (2 U.S.C. 622(11)), as
25 added by section 3(b)(2) of this Act.

Statement of Senator Don Nickles
Governmental Affairs Committee
Biennial Budget Cycle
June 7, 1988

Mr. Chairman, the issues surrounding congressional budget reform are challenging but necessary. Congress needs to consider many options under budget reform and choose the most effective solutions. As a member of the Senate Budget Committee, I would welcome a two-year budget cycle and believe it would benefit the overall budget process. I thank the distinguished Chairman and committee members for recognizing the desperate need to streamline the budget process and I am pleased to be a part of changing this complicated and time-consuming process.

In recent years, Congress seems increasingly unable to work through its legislative agenda. The budget resolution, reconciliation bill, and appropriations take up more and more time. Authorizing committees are squeezed out of the schedule and continuing resolutions become larger every year, as fewer regular appropriations bills are enacted.

It was the Budget Summit Agreement last year that technically gave us our first biennial budget. We now find ourselves nearly on schedule with the budget process. This is due to the fact that we arrived at set spending levels a year in advance. Our work was virtually done for us this year because of the spending levels agreed upon last year. I think we could have made substantially larger cuts in many areas of the budget during last year's summit, but the system as a whole has improved tremendously over previous years.

With a two-year budget cycle in place, Congress could spend every other year carefully examining entitlement programs and weeding out wasteful spending in all areas of the budget. Deficit reduction must continue to be our primary goal in the budget process. Congress must prove to the American people that it can spend their money responsibly, and the biennial budget cycle is a positive step in that direction.

We must own up to the fact that we do not have enough money to fund every new program coming down the pike. We do not even have enough money to fund existing programs. As an appropriator, I know how tough it is to turn down one project in favor of another. I also know that we cannot continue to spend money that we do not have. Solutions must be sought to stem the rising tide of debt in this country. I believe that one of the solutions is the creation of a 2-year budget cycle.

I am aware of the efforts of Senators Ford and Roth in the drafting of a bipartisan bill that would provide for a 2-year budget cycle. I commend them for their timely work and I would be pleased to join them in sponsoring this legislation when it is introduced in the Senate.

STATEMENT OF SENATOR PETE V. DOMENICI
BEFORE THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
ON BUDGET REFORM
June 7, 1988

Mr. Chairman and members of the Committee, let me thank you for the opportunity to testify today. I also want to express my appreciation to you, Mr. Chairman, for scheduling this hearing. With all of the talk these days about the need to reform the budget process, the time has come for the Senate to give the issue more serious consideration.

The logical place to start is to talk about what is wrong with the system we have now. To a large extent, your view of the problem depends on where you sit. If the committee would indulge a bit of overgeneralization, I would characterize some of those views as follows:

- o For a United States Senator, there is too much duplication, too many votes on the same issue, and too much time spent on budgeting.
- o From the viewpoint of the Executive Branch, the balance of power over fiscal matters has swung too far away from the President.
- o For members of the Appropriations Committee, problems come from delay in adopting the budget resolution and inadequate control over entitlements and other mandatory spending.

- o For the average citizen, the budget process is probably too complex to be comprehensible.

As one who has invested a great deal in the budget process, I find truth in all of these statements. Yet I believe that the process put in place by the Congressional Budget and Impoundment Act of 1974 is fundamentally sound.

We could improve the quality of our decisions -- and the quality of life in the Senate -- by making a few changes around the edges. But we do not need to rebuild, from the ground up.

With all due respect to my friend, the Senator from Kansas, I do not believe that we should embark on a major restructuring of the Senate. In fact, I would argue that combining authorizations and appropriations into individual committees would loosen, not strengthen, the budget process.

Separating legislation from appropriations is a principle which dates back to the earliest days of the Congress. There was, however, a period in the late 19th century when legislative committees wrested control over spending bills from the appropriations committees. According to one scholar, this "raid on the jurisdiction of the Appropriations Committee was due principally to the desire to provide more ample appropriations."

I am not suggesting that those who advocate combining appropriations and authorizations today have the same motivation. But I am concerned that this arrangement would only make it more difficult to contain the Congressional appetite for spending.

Before offering my own recommendations, let me emphasize one point. We do not have a deficit because of the budget process. Had it not been for the reforms of the 1974 Congressional Budget Act, we would be in much worse shape than we are today. But because of dissatisfaction with current procedures, and of course with the end result, some might be tempted to throw out the whole system.

I do not believe that attempting a major overhaul is warranted or wise. Not only am I skeptical about the chances for success, but I am also concerned that such efforts would deflect attention from the more important problem of the deficit.

Instead, I would pursue a more modest agenda, with three major goals in mind: reducing the load; simplifying the process; and improving enforcement. My specific proposals are as follows:

1. Adopt a biennial budget. While I believe we have to simplify, we also have to accept that fact that putting together a \$1 trillion budget will always be a complicated and contentious undertaking. Rather than adopting a budget every year, why not accommodate that reality by switching to a two-year budget?

I know that this committee has an interest not only in how a biennial budget would affect Congress, but also in how it would affect the operations of government. Last year, during Appropriations Committee hearings, I asked as many agencies as possible about the feasibility of such a plan. Out of 55 agencies, 41 (or three-quarters) expressed clear support; six

expressed support but with major reservations; and eight took no stand.

In the first session of the 100th Congress, two major biennial budget bills were introduced in the Senate -- one by Senator Ford and one by Senator Roth and myself. Now the Senator from Kentucky and the Senator from Delaware have joined forces to produce a single bill, which I understand will be introduced soon.

The Ford-Roth bill includes a new provision, which I strongly support, allowing for automatic continuing resolutions when Congress does not pass individual appropriation bills in time. But it also includes a few provisions which I do not favor, dealing with reporting requirements and access to Executive Branch budget documents.

Despite these objections, I commend the Senators Ford and Roth for their efforts and look forward to working with them to secure passage of a biennial budget bill.

2. Simplify the budget resolution to include only broad allocations and make these allocations binding. When we adopt a budget resolution, we set totals for 20 different functions of government -- national defense, international affairs, agriculture, education, and so on. These functions do not correspond to either agencies or committee jurisdiction.

Although we allocate budget authority and outlays to committees under Section 302(a) of the Budget Act, the function totals adopted in the budget resolution are not binding. For

example, the Appropriations Committee is free to spend amounts allocated to it as it sees fit, no matter what Congress thinks it has agreed to in the budget resolution.

Last year's budget summit agreement established allocations for three categories of discretionary spending: defense, international affairs, and domestic. I recommend that we replace the functional allocations now required in the budget resolution and extend a concept similar to that adopted in the summit.

At the same time, we would make these broad categories binding, as they effectively are under the budget summit. This way, when Congress made a decision on spending limits in the budget resolution, it would mean something.

3. Enforce more than just the first-year totals in the budget resolution. When we adopt a budget resolution, it usually covers three years. In addition, Gramm-Rudman-Hollings has established deficit targets for the next five fiscal years. Yet all of our enforcement mechanisms key only to the first year.

Let's say that a bill comes before the Senate whose cost in the first year fits within the budget resolution totals. But we know that in the next few years, it clearly busts the budget. This situation occurs all of the time and there is nothing we can do about it. Congress passes the bill and then we wonder why outyear spending continues to increase.

4. Strengthen controls over new entitlement and mandatory spending. As it currently stands, the Budget Act places some limitations on the consideration of new entitlement authority.

But these limitations are weak and easily avoided, simply by inserting language making the new spending subject to appropriations.

This leaves us with legislation that requires payments which the appropriators have no choice but to fund. Interest payments on bonds used to bail out the Farm Credit System is one example of this problem; restitution payments promised to Japanese-American internees will probably be another.

5. Change Gramm-Rudman-Hollings to better integrate it into the ongoing Congressional budget process. We often hear references to the three-layered Congressional budget process: budget, authorizations, and appropriations. Gramm-Rudman-Hollings created a fourth layer and -- no matter what its merits -- may be the straw that breaks the camel's back.

If we are to continue making progress on the deficit, we need to have the kind of enforceable targets established by Gramm-Rudman-Hollings. But I also believe that it is a prime candidate for simplification. We should consider changing the timetable under the act, as well, to remove the incentive for delay in the appropriation process which it has created.

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United States Senate

COMMITTEE ON THE BUDGET
WASHINGTON, DC 20510-8100

June 17, 1988

The Honorable John Glenn
Chairman
Committee on Governmental Affairs
U.S. Senate
Washington, D.C. 20150-6250

Dear Mr. Chairman:

I appreciated the opportunity to testify before your Committee last week on reforming the Congressional budget process. Clearly there is increased interest in a two-year budget and appropriation process. I look forward to working with you and Senator Roth as you proceed to consider this legislation.

As your Committee and the Congress at large considers alternatives to the current processes, it is critical that the facts used to justify various alternatives be accurate. In this regard, during the hearing Senator Sasser cited a GAO study that purported to show that fully 60 percent of the votes taken by the Senate last year were "budget related." I was unaware of the study and raised some concern about the definition of "budget related." Subsequent to the hearing I have had my staff review this statistic and have found that my concern was well placed.

The table enclosed with this letter presents data compiled by the Library of Congress and published annually in Vital Statistics of Congress. In 1985 the Senate did in fact cast 60 percent of its vote on budget related issues, but this included authorizations, appropriations, tax legislation, debt limit, budget resolutions, and reconciliation bills. Apparently any bill or amendment to a bill that had some monetary reference was classified as "budget related." In 1986 this percentage declined to 51 percent.

More importantly, the percentage has remained fairly constant over the years, even including the years prior to the enactment of the Congressional Budget and Impoundment Act of 1974. Note that in 1965, the percentage of budget related votes in the Senate was 48 percent.

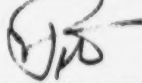
If the criticism of budget related votes is limited to those bills or amendments that result from new activities authorized by the Budget Act, note that in 1986 only 14 percent of all votes in the Senate were budget related.

Page 2
June 17, 1988
The Honorable John Glenn

I fully support the need to make changes in the processes of the Congress. If the suggestion that 60 percent of the Senate's vote activities is a result of the 1974 Budget Act, I believe that this is clearly misleading and not at all helpful to constructive reform proposals for the entire legislative process on Capitol Hill.

I stand ready to assist and help you and your Committee in producing an effective, representative, and efficient system for setting fiscal policies in this country.

Sincerely,



PETE V. DOMENICI
United States Senator

Enclosure

Copies of letter sent to Senator Roth, Senator Chiles, and Senator Sasser.

Table 7-9 Budget-related Roll Call Votes in the House, Selected Years,
1955-1986

Measure	1955	1960	1965	1970	1975	1980	1981	1982	1983	1984 ^a	1985	1986
Authorizations	27	28	78	77	147	105	70	71	129	119	95	112
Appropriations	47	46	78	77	147	105	70	71	129	119	95	112
Tax legislation	6	16	21	39	94	111	85	79	112	76	82	93
Budget resolutions	3	3	3	1	48	14	7	3	9	5	11	3
Reconciliation bills	—	—	—	—	12	30	13	36	4	10	10	8
Debt ceilings	—	—	—	—	—	6	12	18	2	5	10	10
Miscellaneous	1	2	2	2	11	7	2	0	3	6	11	4
Total budget-related roll calls	0	1	0	2	8	4	7	8	3	1	1	1
Total roll calls	37	50	104	121	320	277	196	215	262	222	220	231
Percentage budget-related	76	93	201	266	612	604	353	459	498	408	439	451
	49	54	52	45	52	46	56	47	53	54	50	51

^a Includes the Deficit Reduction Act on which there were four votes, categorized as follows: Tax Legislation, 3, and Reconciliation, 1.
 Sources: For 1955-1982, Allen Schick, "Legislation, Appropriations, and Budgets: The Development of Spending Decision-Making in Congress," Congressional Research Service, Library of Congress, Washington, D.C., 1984; for 1983-1986, House Appropriations Committee.

Table 7-10 Budget-related Roll Call Votes in the Senate, Selected Years, 1955-1986

Measure	1955	1960	1965	1970	1975	1980	1981	1982	1983	1984 ^a	1985	1986
Authorizations	22	48	87	83	96	82	55	31	58	62	67	33
Appropriations	12	28	27	77	87	128	130	109	107	76	59	74
Tax legislation	2	10	10	6	48	10	56	30	13	21	7	26
Budget resolutions	—	—	—	—	8	50	26	35	34	1	39	14
Reconciliation bills	—	—	—	—	—	4	63	18	2	1	23	12
Debt ceilings	0	2	1	3	3	6	12	19	15	7	29	14
Miscellaneous	1	0	0	1	4	3	2	30	9	1	6	10
Total budget-related roll calls	37	88	125	170	246	283	344	272	238	169	230	183
Total roll calls	87	207	258	418	602	531	483	465	381	292	381	359
Percentage budget-related	43	43	48	41	41	53	71	58	62	58	60	51

^a Includes the Deficit Reduction Act on which there were 47 votes, categorized as follows: Authorizations, 27, Tax Legislation, 19, and Miscellaneous, 1.

Sources: For 1955-1982, Schick, "Legislation, Appropriations, and Budgets"; for 1983-1986, Senate Appropriations Committee.

Committee on Governmental Affairs
United States Senate

June 7, 1988

Opening Statement
Senator Nancy Landon Kassebaum

Thank you Mr. Chairman. I appreciate this opportunity to address the Committee on the subject of budget reform, and congressional reform. Along with others who have spoken here today, I too support a two-year congressional budget cycle. I am pleased to be a cosponsor of the Ford-Roth Bill, and I believe the reforms advocated therein are long overdue.

In addition, Mr. Chairman, as you know I have also joined with Senator Inouye in introducing legislation which addresses procedural reform from a more sweeping perspective. Senator Inouye and I have given a great deal of thought to the question of how best to reform the policy-making machinery of Congress. Our suggested approach to that task is embodied in S.Res. 260.

Much has been written lately about the level of discontent around this body. The bulk of that commentary has focused on the so-called "quality of life" issue. While I agree that quality of life is important, I believe there are much more basic and compelling reasons why reform is imperative.

If Congress hopes to function effectively as a co-equal branch of government, institutional reform is a necessity. Unlike the executive branch, which acts on the authority of the President, Congress can only act through consensus. Finding consensus among 535 people is never an easy undertaking. The process used to achieve consensus should not make the task more difficult.

The Senate must, of course, have rules and procedures. Without structure, orderly deliberations would be impossible. However, if those rules ignore the need for efficient action, the Senate will be largely limited to a role of reacting to administration policy initiatives rather than fulfilling our constitutional obligation, which is setting policy. That is the primary reason why I believe reform is not only necessary but imperative.

The task is not impossible. Given a workable legislative format, 100 senators can participate in making policy. I would suggest, however, that there is no conceivable format under which 100 senators can lead in making policy. Unfortunately, I believe that is exactly what we are trying to achieve under existing rules and procedures.

All of us may have been created equal, but all U.S. senators cannot hold equal power. We elect leaders--majority and minority leaders, committee chairmen and ranking members--but some of us don't want to let them lead.

I know of no serious enterprise--private or public, profit or nonprofit, military or civilian, domestic or foreign--other than the U.S. Senate, where reforms have been undertaken with the avowed intent of making everyone chiefs and eliminating all the Indians. That, however, is exactly what we have been attempting to do for the past 20 years. Unfortunately, we have been quite successful, and the result is verging on chaos.

Mr. Chairman, I realize the Senate has a long tradition of affording procedural protections to all members. That practice, perhaps more than any other, serves to distinguish the Senate from other legislative bodies. As a member of a minority party, I fully appreciate the importance of such protections. I would suggest, however, that there is a distinction between accommodating divergent views and accommodating dilatory intent.

In "pre-Watergate reform days," when this balance was lost, the Senate--tradition notwithstanding--usually acted to assert itself on the side of legislative efficiency. Even the most sacred of traditional Senate protections--the filibuster--was modified in the name of efficiency in 1975, when the vote required to invoke cloture was reduced from two-thirds to three-fifths.

Today, we face a legislative crisis much more serious than the one that precipitated the modification of cloture. Put simply, Congress is losing its ability to make policy. That failure does not mean that government policy-making will cease. As long as we have an executive branch we will have national policies. The Pentagon, for example, is fully capable of formulating and implementing national defense policy. Our failure to act simply means Congress will neither prescribe nor oversee government policies. That, I suggest, has begun to happen.

It is vital that Congress begin reasserting its constitutional prerogatives in the area of policy formulation and oversight. That, I believe, can only happen if we are willing to modify our framework of procedures and practices to increase the efficiency of the deliberative process. It is in the hope of furthering that objective that the senator from Hawaii and I introduced S.Res. 260.

Our measure attempts to improve legislative efficiency by, first, vesting responsibility for setting policy priorities with a leadership committee. Those who serve as chairmen and ranking members of legislative committees will serve on the Leadership Committee. They will assume the duties and functions currently performed by the Budget Committee.

The Budget Committee, by virtue of the fact that it produces and enforces the congressional budget resolution, has defacto control over setting policy priorities for the Senate. This task is the proper province of the Senate leadership. For that reason we have eliminated the Budget Committee and vested its duties with the Leadership Committee.

Second, under S.Res. 260, the responsibilities for authorizations and appropriations are consolidated under individual legislative committees.

Authorizing legislation would be reported to the floor with appropriations language included. The need for repetitious debate would be greatly reduced. This would not only speed up the legislative process, it would also reduce opportunities for narrow, special interest amendments which tie up floor action.

Third, S.Res. 260 restructures committee jurisdictions. Standing committees are reorganized so that they cover, to the greatest extent possible, a single, broad policy area. This restructuring uses existing committee jurisdictions as a starting point and attempts to protect the central core of existing committee jurisdictions from reshuffling.

For a committee like Armed Services, committee jurisdiction would remain virtually unchanged. For other committees, like Finance, for example, the restructuring would be much more dramatic.

The Finance Committee would become the Committee on Economic Policy. It would be responsible for all areas of revenue and bonded debt which are now under Finance jurisdiction, as well as all areas relating to banking, monetary policy, coinage, and the Federal Reserve, which are currently under the Banking Committee. Finance would lose jurisdiction over Social Security, Medicare, and Medicaid, which would be transferred to the Committee on Social Policy--the reconstituted version of the Labor and Human Resources Committee.

Significant bipartisan support for structural changes of this general nature has been expressed by members of the Senate for a number of years. For example, in testimony before the Quayle Commission, Senator Hatfield said he felt the Budget Committee should be composed of the chairmen of the authorizing committees.

Senator Stevens, also addressing the Quayle Commission, voiced support for combining the budget and appropriations process as well as the authorizing and appropriating processes.

Our former colleague, Senator Tower, expressed similar views when he testified that there was neither the time nor the need for the Senate to consider major legislation twice each year. He advocated elimination of the Budget Committee, with the powers of that committee given to the Appropriations Committee. Senator Tower added that if the Budget Committee were retained it should be made up of authorizing committee chairmen and ranking members.

Consolidation was also supported by Senator Nunn in the form of a combined Budget/Appropriations Committee with enhanced authority to enforce committee decisions once sanctioned by the Senate. Howard Baker indicated that, although he no longer favored eliminating authorizing committees and assigning their duties to a "super appropriations committee," he had considered the possibility of providing for authorizations and appropriations in the same bill.

While I would not propose to suggest that all those who voiced opinions about the need for procedural reform would support the Kassebaum-Inouye approach, I believe they would find much to recommend it. Our proposal follows the suggested general direction of their recommendations. In doing so, it recognizes what I believe was strongly alluded to in much of their testimony: that congressional efficiency cannot be significantly improved without an increase in the centralization of power in Congress.

Enactment of the reforms we are proposing would provide Congress with an opportunity to regain a prominent position in the formulation of national policy. It would also provide a real opportunity for making the fiscal policy deliberations of the 101st Congress a meaningful exercise. We could, once again, actually make decisions of substance on the floor of the Senate.

Thank you.

United States General Accounting Office

GAO

Testimony

For Release
on Delivery
Expected at
9:30 a.m. EDT
Tuesday
June 7, 1988

Budget Reform for the
Federal Government

Statement of
Charles A. Bowsher, Comptroller General
of the United States

Before the
Committee on Governmental Affairs
United States Senate



Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to discuss important budget reform issues with you today. We are all aware of the Congress' frustration with the budget process. My concern is that the Congress' frustration will lead to a proliferation of proposals for mechanistic and possibly unrealistic budget approaches. I would prefer instead to find ways to improve the vitality of the normal legislative process in the budget area. I will outline four kinds of changes today that we think could help in that regard.

First, the congressional budget process needs to be streamlined. Changes are needed to help the Congress complete its budgeting tasks on time and still have adequate time for oversight and other legislative activities. Later in my statement, I will be discussing various proposals for streamlining the process, including biennial budgeting and proposals for strengthening leadership structures and procedures.

Second, the budget itself should be restructured. We are proposing a new "four-part" budget structure which would differentiate between operating expenses and capital investments and between trust and non-trust funds. This new structure would permit decisionmakers to consider the relative merits of spending for short-term consumption versus spending for long-term capital investments, thus providing a more complete and sounder basis for

deficit reduction actions. Such a structure would also "unmask" the degree to which trust fund surpluses serve to hold down the reported unified budget deficit.

Third, there should be better budget reporting of certain costs. We propose congressional "up-front" appropriations for credit program subsidy costs and appropriations to fund the liabilities of federal civilian employee retirement programs, similar to what is now done for military retirement programs. Also, we suggest an accrual based recording of the outlays for payroll and certain entitlement programs in order to minimize opportunities to manipulate payment dates and to report misleading budget "savings."

Finally, the budget numbers should be upgraded. We propose steps to upgrade the numbers in the budget by using more realistic economic assumptions and upgrading agency financial management systems.

Before I discuss these issues in more detail, however, I would like to take a few minutes to address the federal government's current budget problems. The most pressing of these is the current imbalance between revenues and outlays--or the annual deficit.

CURRENT BUDGET PROBLEMS

The number one fiscal problem facing the nation today is the federal budget deficit and how to reduce it. We as a nation are faced with making fundamental policy decisions regarding how much we are going to spend on governmental programs and services and how we are going to pay for them. For 19 consecutive years, there has been an imbalance between the annual revenues flowing into the federal government and the amount spent on government programs and services. During the 1960's, deficit spending was kept close to 1 percent of the Gross National Product (GNP), except for fiscal year 1968--the height of the Vietnam War--when it reached 3 percent. In the 1970's, however, we began to see substantial increases in our annual deficits--reaching 3 or 4 percent of the GNP by the mid-1970's and then jumping to 5 or 6 percent by the mid-1980's. This represents a substantial increase since 1969. In nominal dollar terms, this growth has been just as staggering. During the early 1960's, the deficit stayed well below \$8 billion. In the mid-1970's, it climbed above \$50 billion, and it reached a all-time high of \$221 billion in 1986.

Until recently, the investors who bought U.S. government securities were largely foreign insurance companies, pension funds, and wealthy investors. As the value of the dollar fell, however, these traditional sources of foreign credit declined, and foreign central banks started buying more U.S. securities to

help prop up the value of the dollar. This has cost central banks in Europe and Japan a lot of money, and it is not something they will be willing to do forever.

I am also convinced that the large budget deficits are directly related to the dramatic growth in this country's foreign trade deficit. In 4 short years, from 1984 to 1987, we went from being a creditor nation to being the world's largest debtor nation. It is hard to get exact figures, but a good guess is that we owe foreign investors at least \$400 billion more than they owe us.

If not corrected, this situation holds great danger for the future. With some major exceptions, many Americans are living fairly well. The problem is we are living well by borrowing the output of other countries' financial institutions and factories. At some point in the future, however, we will have to pay it back by consuming less as a nation. We will all feel it then in the form of a relatively lower standard of living.

In an effort to reduce the budget deficit, the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings) was enacted. The idea of the original legislation was that we would reduce the deficit incrementally from \$221 billion in fiscal year 1986 to zero in fiscal year 1991.

By fiscal year 1987, we had made some headway in reducing the deficit--a reported \$150.4 billion or 3.4 percent of the GNP. It would have been higher except that the 1986 tax reform law "front loaded" revenue in the early years of its implementation, and this revenue was counted against the deficit. By last fall, however, it was clear that we would not reach the original goal of \$108 billion for fiscal year 1988, set by Gramm-Rudman-Hollings, so the Congress decided to change and stretch out the targets. The new deficit reduction targets, as set forth in the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987, are \$144 billion for fiscal year 1988, falling to zero by fiscal year 1993. I want to stress that these are only targets. We must continue to make tough decisions on both the revenue and spending sides of the budget if we are to realize these targets.

A closer look at the programs that make up the budget gives some indication of the difficulty of making those decisions. Entitlement programs alone comprise over 46 percent of the estimated outlays for the fiscal year 1989 budget, while interest on the national debt represents another 14 percent. In fact, annual net interest is actually \$22 billion greater than fiscal year 1989's projected deficit. Defense uses another 27 percent of the budget. This leaves 13 percent of the budget. As a result, even if Defense spending is held steady or reduced somewhat, there is not much left to cut.

The November 1987 Congressional-White House "budget summit" agreement, which set broad budget targets for fiscal years 1988 and 1989, showed that difficult revenue and spending decisions can be made if the top elected leaders from the legislative and executive branches are determined to make them. It was also an example of macro-level biennial budgeting. Although agreement was reached on cutting the deficit, which was an accomplishment, I believe the financial markets and the public are expecting more than short-term actions on the deficit. They are looking for more discipline and accountability in how we manage the government's financial resources.

Unfortunately, the budget process is not working as well as it should. One concern that I have is that the administration and the Congress seemingly are increasingly using "budget gimmicks" and "quick fixes" to reduce the deficit. Often these actions have no real effect on the deficit and can even be counterproductive in the long run. The practice of slipping paydays and conducting loan asset sales are two cases in point.

The Department of Defense (DOD) shifted military service retirement payments from September 30, 1984, to October 1, 1984, which resulted in a fiscal year 1984 budget "savings" of nearly \$1.5 billion. However, the savings were lost in fiscal year 1985

because DOD made 13 retirement payments rather than the normal 12. Similarly, in fiscal year 1987, the Congress directed DOD to slip its payday from September 30, 1987 to October 1, 1987, which helped reduce the deficit by about \$1 billion for fiscal year 1987. However, no real savings were achieved because the liability to make the payments had already occurred.

The use of loan asset sales as a means of reducing the deficit is also of questionable merit. Sales of existing loans in effect shift future loan repayments to the year of sale. Although cash receipts are therefore increased in the year of the sale, such sales do not create additional cash receipts over time above the revenues that would have been received through loan repayments if the loan had not been sold. In fact, if the sale or prepayment of existing loans yields net sales proceeds or prepayment amounts less than the present value to the government of future loan repayments, budget deficits over the long term will increase.

I believe we are all beginning to see indications of the Congress' increased frustration with the budget process. Members increasingly complain that they spend too much time on budget matters, fail to meet budget calendar deadlines, are forced to deal with overly complex omnibus spending bills, and fail to make sufficient progress in reducing the deficit. Our concern is that the Congress' frustration will lead to a proliferation of

proposals for mechanistic and possibly unrealistic approaches to budgeting. These could include rigid formula limitations on budgetary outcomes, such as a constitutional amendment limiting spending growth or requiring a balanced budget. The government took a step in this direction with enactment of the Gramm-Rudman-Hollings legislation--an acknowledgment that the normal budget process was not working well and that something was needed to force greater budgetary discipline. Perhaps Gramm-Rudman-Hollings helped us get the deficit down to \$150 billion, but it concerns me that the government had to resort to this kind of approach. I would like to find alternative ways of improving the vitality and efficiency of the normal legislative process in the budget area.

We need to be realistic, however, in what we can accomplish. I do not think that we can devise new procedures that will completely overcome the delays and inefficiencies of the current budget process. To a large extent, the difficulties our elected officials experience in reaching consensus on budget matters reflects underlying divisions and uncertainties in the American public about policy choices and priorities. Nevertheless, I think that there are changes that could help. To the extent that we can make the budget process less and documents less complex and more understandable, we will have taken a step forward.

Hopefully, the newly established National Economic Commission (NEC) also will address this matter. The last major reforms of the budget process were in 1969 and 1974. It is time to make a fundamental reexamination of the usefulness of the current budget. I would hope that the NEC deliberations and hearings such as these here today will provide the groundwork for major budget reform.

Mr. Chairman, I believe that we can improve budgeting in four ways: streamlining the budget process, restructuring the budget, improving the budget reporting of costs, and upgrading the quality of budget numbers. These should not be seen as "solutions" to our budget deficit problems, but rather as steps that can help our policymakers in making decisions and in taking action on the budget and the deficit.

The remainder of my statement will address our proposals in these four areas.

**STREAMLINING THE CONGRESSIONAL
BUDGET PROCESS**

I think that most of you would agree that the congressional budget process needs to be streamlined. I share concerns that the process is taking up too much time and producing disappointing results.

Budgeting Takes Up
Considerable Time

While it is difficult to prove the point with statistics, I have the sense that budget-related activities are probably taking up too much committee and floor time, even considering the unusually difficult decisions that have to be made these days to get the deficit under control. A Congressional Quarterly study showed that the percentage of budget-related roll-calls in the Senate increased from an average of 43 percent in the 1955 to 1975 period to an average of 60 percent over the 1980 to 1985 period. These figures indicate an increase in budget-related roll-calls. An equally important trend, which such figures cannot easily reflect, is an apparent increase in congressional frustration levels at the cumbersome and time-consuming budget process. It is significant, I think, that several of the Senators who announced their intent to retire from the Senate within the past year have cited such concerns as having influenced their decisions to step down.

I would suggest that, in addition to basic divisions in the public and the Congress over policy choices and priorities, there are other factors contributing to the budget problems. One is that each chamber's procedures--time-honored and valuable in many ways--have seemingly become burdened of late by excessive layering and duplication on budget-related matters. Instead of thinking of a single budget process, it would be more accurate

today to think of six spending-related processes involving different leadership structures, immense coordination problems, a long line of congressional "veto" points, and numerous revisited decisions. I am referring to the annual functions performed by the authorizing, appropriations, and budget committees, plus the added activities related to the periodic debt ceiling extension, the annual Gramm-Rudman-Hollings process, and, one could add, the late 1987 budget summit between the Congress and the White House. It is hard for me to see how any congressional leadership could expedite budget-related actions under such circumstances.

I also sense that another factor contributing to the budget workload is a certain lack of discipline in the procedures. In this regard, I would mention the non-binding nature of the budget resolutions, the lack of Senate restrictions on non-germane amendments, the incomplete budget resolution enforcement provisions, and the ease with which enforcement provisions may be waived. These features keep "flexibility" in the procedures, but at a high price. They invite revisitings of issues and make the budget process vulnerable to extraneous and time-consuming delays. I think that this gives members of the Congress a feeling that the budget process is out of control and never-ending.

Missed Deadlines and
Related Matters

Disappointing results in terms of missed deadlines and the kinds of budget packages delivered for final action compound the problem. The missed deadline matter is a familiar theme, as you know Mr. Chairman. It has been pointed out several times over the years since enactment of the Congressional Budget and Impoundment Control Act of 1974, that the only fiscal year for which all appropriations bills were enacted before the start of the new fiscal year was 1977.

This did not present a major problem in the 1970's. Whenever appropriations were late, a continuing resolution was enacted on time, or agencies continued to operate and incur obligations until appropriations were passed. The Attorney General's opinions of 1980 and 1981, which stated that the Anti-Deficiency Act precluded agencies from operating in absence of appropriations, changed all that. In more recent years, however, there have been two new disturbing developments.

First, the continuing resolutions themselves have not always been enacted on time, leading to partial shut-downs in governmental operations. There were late continuing resolutions in fiscal years 1980, 1982, 1983, and 1984, with resultant funding gaps, extra costs, and, most of all, heightened concern about the way we do business in the nation's capital. Second,

the continuing resolutions have been increasingly expanded in scope to the point where the ones for fiscal years 1987 and 1988 were omnibus bills covering all agencies. The final 2,100-page resolution for 1988 was enacted 3 months into the fiscal year after only a few hours of debate, reminiscent of the way omnibus budget reconciliation was first used for fiscal year 1982. Such procedures shortcut deliberations and, I think, weaken the legislative process. Omnibus continuing resolutions also place practical restrictions upon the President's veto options.

Numerous proposals have been put forward to address these kinds of problems and to improve the congressional and executive budget processes. I would like to address the more prominent of these, beginning with biennial budgeting proposals.

Biennial Budgeting

Some members of the Congress have proposed biennial budgeting as a way to streamline the budget process and free up time for more oversight and authorizing activities. At this time, there are nine biennial bills being considered--three in the Senate and six in the House. The Senate bills are the Ford-Roth Biennial Budget Bill; S. 832, introduced by Senator Domenici; and S. 1362, introduced by Senator Kassebaum. Generally, the Senate and House bills are similar in several respects. They require the President to submit a 2-year budget,

the Congress to adopt a single 2-year budget resolution, and the Congress to enact 2-year appropriation bills. Differences between the proposals occur mainly in the timetable of actions needed to implement the 2-year cycle by the Congress.

The three Senate bills and House bills H. R. 1558 and 2733 would require the Congress to finalize the 2-year budget and appropriations during the first session of each Congress, with the biennium beginning October 1 of that session (the odd-numbered year). Under these proposals, the second session would be devoted to oversight activities or authorizing legislation, plus any adjustments needed to the budget and appropriations for the current biennium. Under the remaining House bills--H. R.'s 22, 33, 777, and 805--congressional budget-related activities would be spread over both sessions of each Congress, with the biennium beginning October 1 of the second session (the even-numbered year).

I believe that biennial budgeting warrants consideration as a possible means of reducing congressional budget workload and allowing more time for oversight and other legislative activities. I would prefer an approach that concentrates budget activity in the first year of each Congress and oversight in the second session. This method offers the advantage of allowing difficult budget votes to come in a non-election year, and it allows budgets to be adopted during the first year of a new

Congress and a new President's term. I also see merit in requiring a single budget resolution with a provision for amending it if the need arises.

In discussing the advantages and disadvantages of biennial budgeting, it is helpful to consider the experiences of the 50 states, since both annual and biennial budgeting have been practiced at the state level for many years. These experiences can be useful to decisionmakers as they consider the various biennial proposals. In July 1987, we issued a report to the House Budget Committee containing the results of our survey of trends and experiences in state governments with biennial budgeting.¹

We reported that more states practice annual budgeting than biennial budgeting--31 states to 19 states, respectively. Of the 19 states that currently have biennial budgeting, 7 have legislatures that meet biennially and therefore cannot have an annual cycle. Furthermore, we found that the trend has been in favor of annual budgeting. During the past 20 years, 15 states changed their budget cycles, with 12 switching to annual budgeting and 3 to biennial.

Most states with biennial budgets report that they spend

¹Budget Issues: Current Status and Recent Trends of State Biennial and Annual Budgeting (GAO/AFMD-87-53FS, July 15, 1987).

less time on budgeting in the off-year, but indicate that the budget forecasts are less reliable because they cover a longer period of time. The most commonly cited results of changing to an annual budget cycle are improved revenue and spending forecasts and increased time spent on budget activities.

I would like to caution that while biennial budgeting could allow for more oversight and other legislative activities, it does have some potential drawbacks. It could lessen congressional influence or control over program and spending matters. There would be fewer scheduled opportunities to affect agency programs and budgets through the budget and appropriation processes. Since this nation's beginning, annual appropriations have been a basic means of exerting and enforcing congressional policy. A 2-year appropriation cycle could change that control. In addition, it is unclear how enacting 2-year budgets and appropriations would affect the Congress' flexibility to make annual changes in program funding levels in response to an ever changing economic, social, and political environment.

I should add that the potential benefits of biennial budgeting may not be fully realized in the current budget environment. In these times of budget uncertainty and changing deficit reduction goals and procedures, biennial appropriations could experience significant off-year adjustments in the form of rescissions, supplementals, or sequestrations. These actions

could, in effect, turn the off-year into another appropriation year with nearly the same work and funding uncertainty.

In my view, these potential problems are not serious enough to negate the possible benefits to be realized from implementing a biennial budget. However, the Congress should be aware of them as it considers the pros and cons of moving to a biennial budget. Also, I believe that the Congress should proceed cautiously on the implementation of a 2-year budget cycle. If adopted, it should probably be tried first on a selective basis.

The Congress has already made some moves towards a 2-year budget cycle. In the fiscal year 1986 Defense Authorization Act, the Department of Defense (DOD) was directed by the Congress to submit a biennial budget for fiscal years 1988 and 1989 and every 2 years thereafter. DOD submitted a 2-year budget for fiscal years 1988 and 1989. However, the authorization committees chose not to approve a full 2-year budget, and the appropriation committees did not provide appropriations for the second year. There apparently were three reasons why the Congress did not provide a 2-year budget. First, the DOD submissions were above the Gramm-Rudman-Hollings deficit reduction targets. Second, there were concerns that a 2-year budget would lessen the Congress' ability to make annual adjustments to the DOD budget. Third, questions were raised over the accuracy of the DOD budget estimates, especially the second-year estimates. I believe that

DOD officials are rethinking their support for biennial budgeting, partly due to a perceived lack of congressional support, and partly because of some problems encountered in the department itself. We are now looking at the DOD experience and will report more fully on it in the near future.

Along these same lines, the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 included a section stating that it was the sense of the Congress that the Congress should undertake an experiment of 2-year budgeting for selected agencies and accounts. The appropriate committees were directed to develop an implementation plan, which also called for an evaluation of the experiment at its conclusion.

I believe that good candidates for this experiment would be organizations with operations and programs which are relatively stable and which have no obvious impediments to the effective testing of the pilot biennial budgeting. Impediments could include activities such as a major reorganization taking place or major changes under way in financial management systems. On this note, GAO recently reported favorably on the testing of a biennial budgeting cycle for the Forest Service, but we recommended that the testing not begin until other budgeting system changes proposed by the Forest Service are completed.

I would also observe that the November 1987 Congressional-White House budget summit agreement was in some ways an application of the biennial budgeting concept. Top leaders from the Congress and the executive branch came together and produced a 2-year agreement on macro budget levels. If it works, this approach may be a way to resolve some of our existing budget process problems.

Other Major Budget Reform Proposals

Several of the Senate and House biennial bills also contain other provisions to streamline or otherwise improve the congressional budget process. Many of those provisions, along with other bills and reform proposals, would address the key problems I outlined earlier in this statement. The ones that I think offer the most promise for lasting improvement are the ones which would enact some kind of permanent continuing resolution, and which would develop more coordinated or integrated leadership approaches.

I think that it is particularly important, Mr. Chairman, to devise leadership procedures and structures to reduce the layering, fragmentation, and duplication that now seems so apparent. Senators Kassebaum and Inouye's S. Res. 260 proposal would require major changes in the structure of existing committees. Senator Domenici, appearing before the Committee on

Rules and Administration last month, proposed the creation of a Joint Committee on the Budget to be patterned after the former Joint Atomic Energy Committee. It would appear that the basic idea of such a joint committee would be to institutionalize the informal, joint approach seen last fall in the "budget summit" talks.

I do not know whether major changes are needed in the committee structure, but I think that it is important to get the elected leadership and chairmen of the major committees working together in a more concerted manner. Such an effort could go a long way toward overcoming many of the budget workload and timing problems we have noted.

Some participants in the congressional budget process have suggested that the Congressional Budget and Impoundment Control Act of 1974 be amended to replace the concurrent budget resolutions requirement with a joint budget resolution requiring presidential signature, so as to minimize later inter-branch disagreements and delays. The November 1987 Congressional-White House budget agreement was a step in this direction. A joint resolution approach, however, would raise its own set of problems. It could raise balance of power questions, since the President would become a more direct participant in the congressional decisionmaking process and, depending on how quickly agreement could be reached on the budget resolution, this

participation on the President's part could either accelerate or delay the whole process. On balance, I believe that more executive-legislative negotiations leading to agreements on budget aggregates, such as occurred in the November 1987 budget summit, would be an important step in the right direction.

IMPROVING THE BUDGET STRUCTURE

I also think that it is time for us to restructure the federal budget. It has been 20 years since the last major reform, when the government's administrative and trust funds were merged into one unified budget. This was the principal recommendation of the 1967 President's Commission on Budget Concepts. The development of a unified budget was unquestionably a step forward, and it should be preserved in any new reforms we undertake.

However, although the current cash-based unified budget largely meets the criterion of being comprehensive, it is severely deficient in its usefulness. Its focus on a single cash-based surplus or deficit total, with no distinction made between investment and noninvestment expenditures, leads to unsound deficit reduction strategies, a budget bias against capital investments, and a distortion of credit program costs. It also masks trust and non-trust (federal) fund fiscal relationships.

These problems partly explain the periodic efforts to remove certain federal programs from the budget. The targeted programs have mainly included capital intensive programs, credit programs, and major trust fund programs.

I believe that the incentives to remove certain programs from the budget would be eliminated or lessened significantly if the current budget's structure were modified to reflect a "four-part" budget approach distinguishing between operating expenses and capital investments, and trust and non-trust (federal) funds. Such an approach would provide budget subtotals for each of these amounts. In addition, deficit reduction targets, such as those in the Gramm-Rudman-Hollings law, would be reformulated around each of the new subtotals. Mr. Chairman, attachments I and II of my statement illustrate our "four-part" budget. I should note, however, that because of our innovative approach and the quality of existing data, we had to make several assumptions. Therefore, I would emphasize that the numbers are approximations for illustrative purposes only.

Let me explain, Mr. Chairman, why I think this new budget structure would help. My comments are directed toward what we see as the budget's underlying problem--its exclusive focus on a single surplus or deficit number.

A Single Surplus or Deficit Total
Does Not Show Capital Versus
Operating Results

Many state officials and private sector executives plan and conduct their activities employing budgets that distinguish between capital investments and operating expenses. At the state level, 37 states have reported that they have distinct capital and operating budgets. In contrast, the federal budget makes no systematic distinction between capital investments and operating expenses. This failure to do so makes it difficult for the Congress to determine how much debt should be incurred each year to finance investments and how much should be used to cover operating expenses.

This is a serious weakness. It can lead to unsound deficit control strategies and to a budget bias against capital programs.

Unsound Deficit Control Strategies

By recent count, 34 states are required by their constitutions or by statute to execute balanced budgets, and most of these states apply these requirements only to their operating budgets. Expenditures for capital investments are not necessarily counted as operating expenses but rather as means of financing capital development. Debt financing and other revenues are utilized for the states' capital projects, subject to separate debt limitations. The liabilities incurred (debt) are

offset by new assets of roughly equal value (the capital acquisition), thereby preserving the states' financial resources.

In contrast, the single-number focus of federal deficit reduction efforts does not recognize the different debt uses for capital investments and operating expenses. Because they represent asset exchanges, capital outlays and debt do not immediately reduce the resource base of the government the way current outlays do. When outlays are made and debt is incurred to acquire assets, whether for physical assets, such as buildings, or for financial assets, such as loans, they produce a stream of future benefits to the government. For example, an acquired building provides facilities to carry out government operations over several years, and an acquired loan note provides a cash return. Therefore, debt incurred to finance capital investment is best thought of as capital financing rather than a deficit.

Failure to recognize the critical distinction between capital financing and operating deficits leads to efforts to reduce all borrowing to zero. Such efforts ignore the importance of making conscious budget policy choices about the relative importance of current consumption versus long-term infrastructure needs.

With a capital budget approach, officials could focus upon sounder and more realistic options. They could readily discuss

and set in public policy the needed balance between spending for short-term consumption needs (operating expenses) and long-term infrastructure and productivity enhancing needs (capital investments). As a result, they could establish deficit targets for operating activities, financing targets for capital activities, and total financing targets for fiscal policy purposes.

Budget Bias Against Capital Programs

Under the present budget rules, a \$50 million outlay to construct part of a hydroelectric plant (a capital investment) in a given year contributes to the year's deficit just as a \$10 million outlay for vehicle or airplane fuel costs (an operating expense) does. However, the full \$50 million for the hydroelectric plant is not a true cost for that year in that \$50 million in federal assets have not been used up. Instead, there has been an asset exchange: \$50 million in cash is exchanged for a \$50 million facility.

The current procedure of "telescoping" the budget recognition of physical acquisition costs into the early years of construction and cash outlays makes a proposed new start appear more costly, on a yearly basis, than it really is. This creates a budget bias against capital investment initiatives, which could lead to uneconomical decisions. For example, decisionmakers might decide to forgo the construction of a building because of

the sizable initial cash outlays that would be reflected in the budget and choose instead another option for space acquisition--leasing--with lower initial budget impact but higher, long-term costs.

A capital budget would improve cost comparability and thereby reduce the existing budget disincentive for physical capital acquisitions. Under capital budgeting, project costs would be "de-telescoped" and distributed over the useful life of the project for purposes of reporting yearly amounts in the operating expenses budget. The amount so reported each year could be identified as an asset consumption charge.

This would not reduce the budget disclosure of actual cash disbursements in a given year. These would be reported in the capital budget part.

Cost comparability of federal credit programs vis-a-vis other programs would also be improved. This issue is similar to the problem now facing physical capital investments. The budget now recognizes the cost of \$25 million in new loans as being \$25 million at the time of their disbursement, even though much of the loan will be repaid. In effect, this treatment overstates the costs of loan programs in their early years, when disbursements exceed repayments. An opposite effect occurs in later years when loan repayments flow back to the programs. The repayments are netted against new outlays to reporting budget

outlays. The budget would thus report "negative outlays" for a year if repayments exceed disbursements.

This distortion of the true costs of credit programs could be corrected under a capital budgeting approach. Subsidy costs would be calculated, showing how much the government loses on given loan programs. The loss amount would essentially reflect any unfavorable interest rate spread, if the government borrowing rate is higher than the lending rate, plus any default losses. The calculated subsidy cost for each year's loans would be reported as an operating expense for the year, and the cash disbursements would be reported as a capital investment.

A Single Surplus or Deficit Total
Does Not Distinguish Between Trust
and Non-Trust Fund Amounts

Another major area of concern relates to trust funds. Since fiscal year 1969, the budget's annual surplus or deficit has reflected the combined results of trust and non-trust receipts and outlays. This has led to two kinds of problems.

First, proponents of some major trust fund programs, such as the Highway Trust Fund program, have stated that including the trust fund amounts in the budget's totals has prompted the Congress and the President to "misuse" those funds to reduce the reported budget deficit. They charge that officials restrict trust fund outlays while maintaining the tax levels, thereby

creating annual trust fund surpluses that are included in the budget's totals and thus lower the reported deficit. It is held that this breaks an understanding or implied agreement underlying the original tax enactment--that is, that the tax revenues would be used for certain program purposes.

Second, observers have pointed out that including the trust fund amounts in budgetary totals has served to "mask" important fiscal relationships and trends. The trust funds' surpluses, when combined with the non-trust accounts' deficits, produce a total that hides the severe deficit on the non-trust fund side of the government's operations. For example, the \$150.4 billion total deficit for fiscal year 1987 does not reveal the fact that the deficit for all non-trust accounts was a much higher \$223.1 billion, offset in the totals by a \$72.7 billion trust fund surplus. Similarly, although the Congressional Budget Office (CBO) projects a declining total deficit through fiscal year 1993, it also projects a growing non-trust fund deficit. Overall decline is caused by the rapid buildup in annual trust fund surpluses.

The masking effect has received considerable attention in recent weeks as writers discuss the implications of the Social Security trust funds' growing balances. The annual balances--that is, annual payroll tax revenues in excess of annual benefit payments--have grown significantly since the 1983 Social Security amendments. The surpluses of these and other trust funds are

required by law to be invested in U.S. Treasury securities, thereby financing the debt incurred for the non-trust fund activities of the government. Some argue that an increasing reliance on trust fund surpluses to finance operating deficits means, in effect, an increasing reliance upon the regressive taxes financing some large trust funds as a means of financing general government operations.

Current projections are that the Social Security trust funds will begin to run annual deficits in the first quarter of the 21st century, requiring the funds' administrators to redeem their Treasury securities to obtain the cash needed for benefit payments. This need not present a problem to the Department of the Treasury, provided there is a sound fiscal balance between the trust and non-trust sides of governmental operations. For example, when the securities are redeemed, if the government is borrowing heavily to finance a large non-trust fund deficit, there could be economic reasons for avoiding significant new borrowings to redeem the securities. In that case, the funds to redeem the securities could be raised through new taxes or spending cuts, but both of these approaches could present problems as well. Unfortunately, the current structure of budget information, with its focus upon a single surplus or deficit total, does not facilitate the kind of analyses needed to ensure a proper fiscal relationship between trust and non-trust operations. A new set of budget subtotals, for trust and non-trust operations, would address this masking problem.

Distinguishing between trust and non-trust amounts would resolve the masking problem. Budgetary information structured along these lines would clearly disclose the trends in both parts. It would also be important to show the intragovernmental flow of amounts between the trust and non-trust parts.

As for the issue of misusing trust funds to help balance the budget, the new set of totals proposed herein would not, in themselves, resolve the issue, but would provide better disclosure of how some trust funds are in fact being used for fiscal, rather than programmatic, purposes.

IMPROVING THE BUDGET'S REPORTING OF COSTS

Mr. Chairman, I also believe that we need to improve on the budget's current reporting of information on program costs. The current budget treatment of credit programs, pension programs, and programs in which the government uses its noncash assets in lieu of cash to obtain something of value to the government provides misleading cost information.

The Subsidy Costs of Credit Programs Are Not Accurately Reported in the Budget

As I noted previously, the current budgetary treatment of credit programs--that is, direct loans and guaranteed loans--does not accurately report the costs of these programs. Furthermore,

the budget does not identify the subsidy costs up front--i.e. when new credit activities are being considered--so that they can be compared to other programs when budgeting decisions are being made. For many years, GAO has advocated changes in the budget treatment of credit programs to address these problems. We believe that the subsidy costs of credit programs should be identified and appropriated annually when the government makes new direct and guaranteed loans. We would combine this new budget treatment of credit programs with our proposed restructured four-part budget.

The Office of Management and Budget (OMB) has recently developed a credit reform proposal which would require that credit subsidies be appropriated for each budget year's new direct and guaranteed loans. We disagree, however, with the way OMB proposes to calculate the amount of the credit subsidy.

OMB would measure the subsidy using a "benefit to the borrower" approach. Under this approach, the subsidy is measured in terms of the economic benefits the borrower receives by obtaining a loan from the government rather than in the private sector. OMB's approach could produce a larger reported subsidy amount than our "cost to the government" approach, because the OMB method would include some costs which would never be reflected in federal budget outlays, such as higher private sector costs of funds and risk premiums in excess of default risk estimates.

The approach which we prefer measures the subsidy in terms of future cash outlays which will impact on budget totals. The subsidy is measured in terms of the costs--interest subsidies and default costs--the government will incur as a result of its decision to issue the loan. It is calculated by taking the difference between (1) the present value of the future principal and interest payments discounted at the government's long-term interest rate and (2) the money loaned out.

Conceptually, GAO favors the cost approach as the more accurate and appropriate budgetary cost measure. We do not endorse introducing costs into the budget which do not reflect the government's cost.

**The Budget Fails To Report the
Future Cost of Today's Commitments**

I am also concerned over the budget's failure to report the future cost of today's commitments. The current cash-based budget reporting provides incomplete cost information on some major future liabilities because it does not include them in the budget totals reviewed by the Congress. The federal government incurs certain liabilities, such as future pension payments, which may not be liquidated (funds disbursed) by cash outlays until long after the liability has been incurred. In such cases, the cash-based budget does not always recognize the liability. For example, as of September 30, 1986, the unfunded liability of the Civil Service Retirement System (CSRS) was nearly \$544

billion. This is the fund's accumulated unfunded liability for future retirement benefits (already earned by current employees and their survivors) which has not been included in budget estimates over the years and which has not been appropriated by the Congress.

Showing the full cost of the CSRS pension plan in the budget would allow the Congress to better consider it on a comparable basis with other government programs. To show the full annual cost of the CSRS pension plan, budget authority should be recorded in each agency's budget to fund the annual accrued liability of employee benefits such as is done for the Federal Employees' Retirement System. In addition, budget authority should be provided to fund all pension funds' unfunded liabilities based on dynamic economic assumptions over a number of years, similar to what is now being done for military retirement.

The federal government also has a number of programs, such as federal employee payroll and certain entitlement programs, which incur liabilities and/or make payments to liquidate (disburse funds) the liabilities on a regular schedule. Since the budget currently focuses on cash outlays, opportunities exist to manipulate outlay levels for such programs by shifting payment dates by a day or two from one fiscal year to another. Because of the size of these payments, changing the payment date could cause a deficit fluctuation of billions of dollars in a given

year. For example, in fiscal year 1987, the Department of Defense (DOD) delayed its payday by one day to the succeeding fiscal year, resulting in a fiscal year 1987 budget "savings" of nearly \$1 billion. However, no real "savings" were achieved because the liability to make the payment had already occurred.

By accruing outlays in the budget for the liability incurred in each fiscal year to make payments for payroll and entitlement programs having regular payment schedules, these programs would not be candidates for budget gimmicks. Such gimmicks, as delaying a cash payment from one fiscal year to the next, do not result in a true reduction in outlays, and they should not be used to aid the administration and the Congress in meeting deficit reduction goals.

**The Use of Noncash Assets To Finance
Government Programs Should Be
Reported in the Budget**

Currently, the budget's totals exclude the costs of some programs with authority to make purchases by giving a seller credits, or something other than money, instead of paying the seller with cash. Governmentwide, agencies have identified 27 accounts which they interpret as having such authority. For example, during fiscal years 1986 through 1989, the Commodity Credit Corporation (CCC) has planned to issue \$28 billion worth of "commodity certificates" as payments to farmers participating in various farm support programs. Farmers can use the

certificates to repay loans, exchange them for commodities in CCC's inventory, turn them in to CCC for cash, or sell them to someone else who in turn can sell or exchange them. The costs of using the commodities in this manner are not included in the budget's totals.

We believe the budget should include the use of noncash assets to finance programs. During the past year, we have studied the budgetary treatment of CCC's commodity certificates in detail. As a result of our study, we are considering various ways to include in budgetary totals the full amount of resources--cash and noncash--devoted to the program. While commodity certificates are but one of the 27 programs authorized to use this type of financing, many of the other 26 programs could also be included in the budget. We will be reporting soon on the results of our study.

UPGRADING THE BUDGET'S NUMBERS

We also believe, Mr. Chairman, that the timeliness, consistency, and accuracy of the budget numbers should be improved. This is not a new problem, but one that has taken on new importance as the Congress and the administration attempt to address the deficit. I think we can make progress on this numbers problem in at least two areas. First, we should consider ways of improving the economic and spending projections put forth in various budget documents. This will not be easy because

legitimate differences of opinion exist on such matters. Nevertheless, I am convinced that we can do better.

I would say that a starting point for achieving better economic and spending estimates would be for officials to base their estimates more on stable economic and financial patterns and less upon optimistic policy and economic goals. There has been a persistent pattern of overly-optimistic budget assumptions and projections, and the trend may be continuing. For example, the recently passed House and Senate budget resolutions for fiscal year 1989 contained an estimated deficit of about \$134 billion, which was based on OMB's economic assumptions which are considered very optimistic by many observers. The less optimistic CBO economic assumptions, however, placed the "baseline" deficit in 1989 at \$176 billion. The revised Gramm-Rudman-Hollings law, however, mandates that OMB projections prevail, so we have set for ourselves a "rosy scenario" for meeting the target in 1989. This raises questions about the usefulness of the numbers, particularly since the projections of many private forecasters are consistently less optimistic.

A second area of needed improvement would be upgrading agency financial management systems. The financial management processes and systems that support federal policymaking, including budgeting, have not kept pace with the needs of the Congress and the executive branch. When budgeting decisions are based on questionable data from antiquated financial management

systems, budgeting problems are compounded. For example, inconsistent practices regarding the treatment of administrative costs may result in the inability to accurately report to the Congress on the implementation of Gramm-Rudman-Hollings. We have been unable to identify how agencies allocated budget cuts between service and administrative operations because some agencies do not identify administrative costs, apply differing criteria, or inconsistently apply criteria in allocating costs to program administration accounts.

Improvements in agency financial management systems would greatly improve the budget numbers. As I stated before your committee last year, Mr. Chairman, the foundation for successful financial reform requires:

- a legislative mandate to ensure continuity and stability of reform issues,
- a central position and office established in law to plan, implement, and oversee the reform effort and to provide continuous central leadership,
- corresponding leadership in executive branch departments, agencies, and bureaus, and

-- a long-range governmentwide plan, developed by the central leadership, for improving and operating federal financial management systems.

One final note on the numbers. We think that the discipline and integrity of the budget numbers would also be helped if more federal agencies prepared audited financial statements. Many statement amounts find their way into the budget, and our GAO financial audits have turned up countless discrepancies and problems with these reported amounts. Continued auditing efforts along these lines should have beneficial effects for the budget.

This concludes my prepared statement, Mr. Chairman. I would be happy to respond to any questions you or members of the Committee may have.

ATTACHMENT I

ATTACHMENT I

FOUR-PART BUDGET APPROACH
TOP-LEVEL SUMMARY
FISCAL YEAR 1987

	<u>Total funds</u>	<u>Federal funds</u>	<u>Trust funds</u>
	---(dollars in billions)---		
Operating Budget			
Revenues	\$ 957.8	\$ 627.2	\$330.6
Expenses	<u>1001.8</u>	<u>625.3</u>	<u>376.5</u>
Cash surplus/deficit(-) before interfund transfers	-44.0	1.9	-45.9
Interfund transfers	<u>-2.2</u>	<u>-117.2</u>	<u>115.0</u>
Cash surplus/deficit(-) after interfund transfers	-46.2	-115.3	69.1
Asset consumption charge	<u>-50.0</u>	<u>-50.0</u>	<u>a</u>
Operating surplus/deficit(-)	<u>-96.2</u>	<u>-165.3</u>	<u>69.1</u>
Capital Budget			
Revenues	\$ 54.5	\$ 37.4	\$ 17.1
Investments	<u>160.9</u>	<u>145.3</u>	<u>15.6</u>
Capital financing requirements	-106.4	-107.9	1.5
Interfund transfers	<u>2.2</u>	<u>-</u>	<u>2.2</u>
Capital financing requirements after interfund transfers	-104.2	-107.9	3.7
Asset consumption charge b	<u>50.0</u>	<u>50.0</u>	<u>a</u>
Net capital financing requirements	<u>-54.2</u>	<u>-57.9</u>	<u>3.7</u>
Total Financing Requirements	<u>\$-150.4</u>	<u>\$-223.2</u>	<u>\$ 72.8</u>

a There are asset consumption charges applicable to trust funds, but we could not ascertain those amounts.

b Asset consumption charges could be used as a basis to finance debt used to acquire physical assets.

ATTACHMENT II

ATTACHMENT II

FOUR-PART BUDGET APPROACH
OPERATING COMPONENT
FISCAL YEAR 1987

	Total funds	Federal funds	Trust funds
	---(dollars in billions)---		
Operating Budget			
Revenues			
General taxes and fees			
Individual income taxes	\$ 392.6	\$ 392.6	\$ -
Corporation income taxes	83.7	83.7	-
Miscellaneous taxes and fees	50.8	50.8	-
Total general taxes and fees	<u>527.1</u>	<u>527.1</u>	<u>-</u>
Earmarked taxes and fees			
Soc. security and railroad retire.	273.0	-	273.0
Unemployment insurance taxes	25.6	-	25.6
Civil service retire.(employee share)	4.7	-	4.7
Customs duties and other receipts	6.9	5.7	1.2
Total earmarked taxes and fees	<u>310.2</u>	<u>5.7</u>	<u>304.5</u>
Other revenues	<u>120.5</u>	<u>94.4</u>	<u>26.1</u>
Total revenues	<u>957.8</u>	<u>627.2</u>	<u>330.6</u>
Expenses			
Social security	204.8	-	204.8
Defense	199.8	199.4	0.4
Interest on debt*	160.3	160.3	-
Income security	135.1	62.1	73.0
Medicare	81.6	-	81.6
Health	42.5	39.9	2.6
Veterans benefits	30.9	29.0	1.9
Other	145.8	133.6	12.2
Credit subsidy costs	1.0	1.0	-
Total expenses	<u>1001.8</u>	<u>625.3</u>	<u>376.5</u>
Cash surplus/deficit(-) before interfund transfers	<u>-44.0</u>	<u>1.9</u>	<u>-45.9</u>
Interfund transfers			
Interest paid to trust funds	-2.2	-35.0	32.8
Fed. employee retire.(employer share)	-	-30.6	30.6
Supplementary medical insurance	-	-20.3	20.3
Civilian supplementary ret. contrib.	-	-16.2	16.2
Military retirement	-	-10.5	10.5
Other	-	-4.6	4.6
Total interfund transfers	<u>-2.2</u>	<u>-117.2</u>	<u>115.0</u>
Cash surplus/deficit(-) after interfund transfers	<u>-46.2</u>	<u>-115.3</u>	<u>69.1</u>
Asset consumption charge	<u>-50.0</u>	<u>-50.0</u>	<u>a</u>
Operating Surplus/Deficit(-)	<u>\$ -96.2</u>	<u>\$ -165.3</u>	<u>\$ 69.1</u>

ATTACHMENT II

ATTACHMENT II

FOUR-PART BUDGET APPROACH
CAPITAL COMPONENT
FISCAL YEAR 1987

	Total funds	Federal funds	Trust funds
	---(dollars in billions)---		
Capital Budget			
Revenues			
Loan receipts	\$ 37.6	\$ 37.4	\$ 0.2
Other capital receipts	16.9	-	16.9
Total revenues	<u>54.5</u>	<u>37.4</u>	<u>17.1</u>
Investments			
Financial asset disbursements, less subsidy costs	<u>34.2</u>	<u>34.0</u>	<u>0.2</u>
Physical asset additions			
Direct federal programs-civil	16.1	14.7	1.4
Direct federal programs-defense	89.6	89.6	-
Grants-in-aid	21.0	7.0	14.0
Total physical asset additions	<u>126.7</u>	<u>111.3</u>	<u>15.4</u>
Total investments	<u>160.9</u>	<u>145.3</u>	<u>15.6</u>
Capital financing requirements	-106.4	-107.9	1.5
Interfund transfers	<u>2.2</u>	<u>-</u>	<u>2.2</u>
Capital financing requirements after interfund transfers	-104.2	-107.9	3.7
Asset consumption charge	<u>50.0</u>	<u>50.0</u>	<u>a</u>
Net Capital Financing Requirements	\$ <u>-54.2</u>	\$ <u>-57.9</u>	\$ <u>3.7</u>

a There are asset consumption charges applicable to trust funds, but we could not ascertain those amounts.

Testimony

on

Budget Reform and Biennial Budgeting

to be delivered by

John J. Rhodes, Co-Chairman

on behalf of the

Committee for a Responsible Federal Budget*

before the Senate Committee on Governmental Affairs

June 7, 1988

*The Committee For a Responsible Federal Budget is a bipartisan nonprofit organization formed to educate the public on the federal budget and on the federal budget process.

The Committee is Co-chaired by Robert N. Giaimo and John J. Rhodes. Roy L. Ash, Thomas L. Ashley, Richard Bolling, Carol G. Cox, James L. Ferguson, Peter M. Flanigan, James R. Jones, Robert D. Kilpatrick, Arthur Levitt, Jr., James Lynn, James T. McIntyre, Jr., W. Henson Moore, Howard Moskof, Edmund S. Muskie, Rudolph G. Penner, Peter G. Peterson, Leland S. Prussia, Alice M. Rivlin, Elmer Staats, David A. Stockman, Robert Strauss, and Paul A. Volcker are on the Board of Directors.

Mr. Chairman, Mr. Roth, Members of the Committee, I am pleased to take this opportunity to share with you my own views and those of The Committee for a Responsible Federal Budget on the issue of biennial budgeting - and on a broader menu of budget process issues.

Before I begin, let me introduce a former Chairman of the House Budget Committee (and Member of the Board of our Committee), Jim Jones. Also with me today is Carol Cox, President of our Committee.

Mr. Chairman, there are any number of proposals to alter our existing budget processes. Some would amend the Constitution to require balanced budgets, to limit the growth of federal spending and/or to give the President authority to veto line items in appropriations bills. Some would amend the Congressional Budget Act. There are those who would abolish the budget process altogether.

If you were to abolish the budget process, you would have to create something else to take its place. Congress needs badly some system within which to consider overall spending and revenue levels -- the resulting deficits and/or surpluses -- and the relative priority of competing functions within the total budget. You need a system which permits you to consider the implications of this year's budget decisions for the future.

Our economic decision-making processes are the result of evolution. Unfortunately, we tend to layer new Committees and Subcommittees on top of the old. In the Executive Branch, they tend to create new Departments and agencies. Who can remember when last we consolidated Congressional Committee jurisdictions -- or eliminated a Department or agency in the Executive branch?

As a result, we have too many groups of people reviewing the same decisions too frequently, and often making decisions too specific, only to revisit these same decisions tomorrow, next week or next month, so no decision seems ever to be final.

The budget process is not perfect, but it is not the problem. The real problem is the problem itself. The United States today faces enormous deficits -- five and one-half years into an economic recovery. If you factor out the social security trust fund surpluses, the deficit is going up -- not down. This is the problem the next President and the new Congress must face -- as soon as possible.

You won't solve all the problems in our economic decision-making processes in time to impact on the debate next year. But there are budget process changes which you should consider at once, as they can help you and the next President to resolve the terrible deficit dilemma we face.

- An agreement to base the package on prudent -- even cautious -- economic assumptions.
- Biennial budget and appropriations.
- Substantial impediments to enactment of supplemental appropriations, during the biennium covered by the initial agreement.
- Enforceable limits on entitlement spending (new and existing entitlements).
- Enforceable limits on both budget authority and outlay levels in appropriated programs, in both the House and the Senate.
- Enhanced rescission, or some similar mechanism, to permit the President to highlight what he believes to be unnecessary spending within large appropriations bills.

Economic Assumptions

Since 1982, Congress has passed, and the President has signed, nine laws which -- taken together -- have cut the deficit by about \$150 billion per year below what it otherwise would have been. Unfortunately, increased interest cost has eaten up just about half of the savings which otherwise would have resulted from the passage of those laws.

To a very large extent, failure to achieve our deficit reduction goals was predictable because we based our budgetary decisions on overly optimistic economic assumptions.

Failure to achieve our goals bred frustration; that frustration led to enactment of Gramm-Rudman-Hollings; and whatever you may think of G-R-H, frustration well could lead to even more stringent remedies in the future, unless we make a conscious effort to ensure that hard decisions made in a timely fashion will produce the desired results.

No one can be sure just what the economy will do in the future. We can, however, plan based on cautious economic assumptions -- in the hope that if we are wrong, the deficit will be smaller, not larger, than advertised.

Biennial Budgets/Appropriations

That brings me to the principal topic of this hearing: biennial budgeting. There is no reason to revisit each and every decision necessary to run a trillion dollar enterprise each and every year. Biennial budgets and biennial appropriations would provide a longer and more certain planning horizon, they should lead to increased efficiency in government, they certainly would help to rationalize Congressional decision-making, and they should provide a better basis for evaluation of the effectiveness of government services and programs.

Biennial budgeting, without biennial appropriations, solves nothing. Just look at what happened in the aftermath of the budget summit agreement.

If you pass a biennial budget, and biennial spending and revenue legislation, in the first session of a Congress, the second session could be devoted to authorizations and oversight. That could improve substantially the quality of Congressional oversight, and might once again lead to a meaningful authorization process.

We understand the difficulty of beginning this process. You must pass fiscal policy legislation in the first session of the new Congress. No new President will want to wait eighteen months to see his program(s) enacted; and yet you simply do not have the luxury right now to delay the decisions on deficit reduction any longer than is absolutely necessary. It is our fervent hope that the next President will put deficit control at the very top of his priority list -- even ahead of his favorite new programs.

The authorizing committees may, therefore, complain that our suggested approach effectively deals them out of the action next year. Our response is to say: this really is just a replay of recent years; except this time the authorizing committees would have a meaningful opportunity to flesh out programs in their jurisdictions, and to complete their very important oversight responsibilities, in the One Hundred and First Congress.

Above all we must stop tinkering with the budget. We should make the best decisions we can, based on the most prudent possible set of economic assumptions; then let those decisions take effect, let the system settle down, stop kidding ourselves that any real benefits result from "fine tuning" fiscal policy at every conceivable opportunity.

Some say, "Congress should preserve the flexibility it has." Let me be blunt. Those who like the decisions you make next year will be happy to leave those decisions alone; the losers in next year's fights will want to fight again the next day, or month, or year; but no one really gains from this perpetual decision making process. Let's try a longer time horizon and see how well it works.

Supplementals

To make this system work, however, you would have to agree to some substantial impediments to passage of supplemental appropriations -- and any other spending and/or revenue legislation -- during the biennium covered by the proposed agreement.

Emergencies may arise. You may have to pass supplemental appropriations. Those bills, however, could become the vehicle to re-open all the decisions reached in your big package -- unless you decide at the outset to prohibit that from happening.

One possible approach to accomplish this could be borrowed from a budget Congress passed a couple of years ago. You said then, Congress could pass supplementals only for specific purposes for which the President requested money. You could appropriate more or less than the President requested, but you could not add to the list of purposes, programs or activities for which the President requested supplemental funds.

All appropriations legislation originate in the House. You could require the House to consider any supplemental on suspension. That would prohibit amendments, and it would require a two-thirds vote for passage. This approach certainly would limit the number and scope of supplemental appropriations.

There may be other -- even better -- ways to limit supplementals. You must, however, address this issue; otherwise, no biennial process ever will produce real two-year budget agreements.

Entitlement Limits

We talk a lot about "uncontrollable" spending. Of course, no spending truly is uncontrollable. Congress chooses to place some programs beyond review through the regular appropriations process. You choose to put those programs on automatic pilot, until and unless you go back and change the basic underlying entitlement legislation. The wisdom of many of these actions deserves serious scrutiny.

As part of any meaningful agreement to get spending and the deficit under control, Congress and the President must reexamine all entitlement spending: ask yourselves which programs should be entitlements (new and existing); and you must agree on binding spending limits -- including limits on entitlement spending.

In the House, Committees and Subcommittees effectively are held harmless from any excess spending due to existing entitlement legislation. There is no point of order against a bill which causes spending limits in the budget to be exceeded -- unless the excess is due to new discretionary budget authority.

You never will have enforceable spending limits until those limits include entitlements. When Committees and Congresses must choose either to cut back on appropriated spending, or to control the growth in entitlements, we will hear less about "uncontrollability," and we will see Congress exercise more meaningful control over the growth in entitlement spending.

Budget Authority and Outlay Limits

In the House, there are no effective controls on spending due to prior year budget authority, and no effective limits at all on outlays.

It is fashionable today, in some circles, to say the deficit problem is the result of too little government revenue. A package to move the budget back toward balance almost certainly will contain provisions for new or increased revenues. Take it from someone who has been out of Congress for a while, however, the American people do not believe Congress wants to raise revenues to cut the deficit. They believe you want to raise revenues so you can spend more money.

To maintain credibility in this effort, you simply must demonstrate that you have done everything you can to control the growth of spending.

Outlays grew this year \$50 billion over last year's levels. That is as much as the total budget of the State of California. It is the seventh largest budget in the world. Surely government spending growth can be contained, but that will require Congress and the President to agree to real spending limits -- and to agree to enforce those limits -- to be bound by the agreements you make.

Once again the budget summit agreement provides a point of reference. Four months after the agreement was signed, the Congressional Budget Committees redefined some "scorekeeping" conventions, to stay within the agreed-to limit.

No one likes limits. Someone always will say "what if interest rates go up, should we cut programs to make up for that?"

The fact is:

Meaningful budgets presuppose meaningful limits on spending.

Enhanced Rescission

After thirty years in Congress, I did not think I ever would find myself defending the Executive's role in fiscal policy.

The Constitution places the power of the purse firmly in the hands of Congress.

Congress initiates spending and revenue legislation. The President may propose, but Congress can disregard the Executive's proposals entirely -- add to or subtract from the President's agenda.

As a practical matter, any agreement on deficit reduction next year almost certainly will be enacted in one, or two, or at the most, three big bills.

Any President confronted with that reality certainly would want an option other than to sign or veto the whole package, in effect the whole government.

Any new President who agrees to use his "honeymoon" period to try to solve the very serious deficit problem we face today should be given some additional latitude in this regard.

We believe that Senator Quayle's enhanced rescission proposal is a good idea. Under current law rescissions die if either House of Congress chooses to ignore them. Senator Quayle's proposal effectively would permit any member of the House or Senate to force a vote on any Presidential rescission proposal. If either House of Congress failed to pass a Presidential rescission proposal, the proposal would die; but the House and Senate would have to vote up or down on Presidential rescission proposals; and as Lud Ashley says, "there is nothing wrong with accountability at both ends of the Avenue."

Summary

This has been a very brief review of the kinds of budget process change we believe could help to expedite passage of major deficit reduction legislation early next year. We believe passage of a package to move the budget back toward balance should be your top priority, as early as possible in the next administration and the new Congress.

We assume that the only way Congress and the next President can act as quickly and as dramatically as we believe they should on the budget deficit is to act on a negotiated package, whether that package be the product of the National Economic Commission, a budget summit, or both. We believe the kinds of process changes discussed above could be included in a negotiated budget settlement.

We do not believe it is possible for Congress to change the budget process permanently at this time. One-time budget process changes next year, however may assist your deliberations on permanent process change. You could implement the suggestions above on a trial basis, see how they work, and if they work well you could write them into the law on a permanent basis.

We believe strongly that a biennial budget would be helpful in solving the deficit control problem, but it is no panacea. It will still take the courage of the majority of the House and Senate, and you will have to cast some very difficult votes, to solve the problem.

If you pass a biennial budget, spending and revenue legislation next year, you could spend the second session of the 101st Congress reviewing budget process change generically -- and you could complete that review without constant pressure to cut the deficit distorting your deliberations.

Toward that latter objective, we have included with our remarks today testimony we delivered last year before the House Government Operations and Judiciary Committees.

That testimony deals with a number of budget process issues, including proposed constitutional amendments.

One of the proposals we deal with in that testimony is the item veto. We were against it then and we still are. But we believe a word of warning is in order. The omnibus appropriation bill -- otherwise known as the Continuing Resolution -- has the practical effect of diluting, if not denying, the right of veto in the Presidency. The Constitution didn't mean for this to happen, and we think the practice is unwise and unfair to the President. We strongly believe that enhanced rescission could address these issues, continue the traditional way of appropriating funds, and lead to better teamwork and balance between Congress and the President. It could, therefore, help get the deficit problem under control.

Mr. Chairman, Mr. Roth, Members of the Committee, if you would agree to incorporate the balance of our testimony in the record of your Committee's hearings, I will pause now, and I, or any of my colleagues from the Committee, would be happy to answer your questions.

PREPARED STATEMENT OF ROBERT W. HELM

Introduction:

Mr. Chairman, Members of the committee, I am pleased to appear before you today to discuss biennial budgeting within the Department of Defense. The FY 1986 DoD Authorization Bill required the submission of a two-year budget for defense and related agencies for fiscal years 1988 and 1989. The Department complied with that requirement and intends to submit its second biennial budget next January for fiscal years 1990 and 1991. We are encouraged by the continuing support for this concept demonstrated by the authorization committees and are hopeful that, next year, the appropriations committees also will endorse biennial budgeting by enacting appropriations for both FY 1990 and FY 1991.

I think that frustration levels with the current congressional budget process are high in both the executive and legislative branches. The process is too time consuming, target dates are missed more than they are met; the authorization bills too often are enacted so late that they are concurrent with the appropriations bills rather than preceding them; and appropriations bills are rarely enacted before the commencement of the fiscal year, resulting in the need for continuing resolutions. As a result, defense budgets are plagued with uncertainty. Authorizations and appropriations are not always consistent; total available resources for program execution are not known at the start of the fiscal year; and each year the spectre of Gramm-Rudman-Hollings sequestration looms over already enacted appropriations. We are very close to a situation where a full twelve months is consumed just getting a budget enacted. There is no time left for the Congress to conduct comprehensive reviews of defense issues. Program managers have little time to develop rational program execution plans based on available resources, when the available resources become known mere weeks before the next year's budget is transmitted to the Congress. The Congress has legislated so many steps, schedules, and targets into the budget process, that the focus is on the process rather than the end product. Ironically, in this period of concern over the deficit, the budget process lends itself to the least economical use of our nation's resources by denying program managers the very tools they need - stability, predictability, and commitment.

Benefits of Biennial Budgeting:

While not the panacea for our budget woes, biennial budgeting offers some hope for improving current budget formulation, review, and execution processes. Most obvious is the freedom from an annual process burdened by delays and repetition both within the Department and the Congress. Annual votes and debates on particularly political issues that often drag the budget process to a standstill would be eliminated, freeing more time for policy planning and oversight. And, biennial budgeting would assure those who would do business with the Department of Defense that there is at least a two year commitment to a specific level of program and resources.

The overriding benefits to the Department from enactment of authorizations and appropriations for two fiscal years at a time would be program and resource stability and resulting economical program execution available to defense managers. Recent experience has not allowed program managers the basic luxury of knowing the program or resource level for a given fiscal year until well into that fiscal year. Biennial budgeting would allow these managers at least one year, and hopefully two, in which they could plan, price, and execute their programs without concern of funding fluctuations.

Biennial budgeting would provide a program manager with advantages currently foregone. Programs funded by annual appropriations have traditionally borne the brunt of budget reductions, particularly those imposed to reduce outlays in the near-term. Unfortunately, these are often the very programs so critical to readiness and day-to-day operations of our military forces. While these are the areas of the budget that have been protected during recent years of severe funding constraints, two years of assured funding levels would guarantee that training miles, flying hours, operating tempos, and joint exercises could be programmed and sustained at required levels. Equally as important, with assured levels of funding in the operating accounts, support for weapon systems and equipment entering service, as well as repair and maintenance of existing inventory, can be effectively planned and provided.

In the area of investment, more obvious benefits can be realized as materials and components can be purchased more efficiently using economic order quantities earlier in the contract

period. This is particularly true of long-lead components, such as those required for shipbuilding or major weapon systems. The ability to employ multiyear contracts has proven cost effective, as the reduced risks to the contractors are translated into lower costs to the government. Biennial budgeting would facilitate the use of multiyear procurement. The assurance of two years of production should attract additional competitors for defense programs, especially those on the margin who, heretofore, may have deemed it not cost effective to tool and train for only one year's effort. Defense contractors would be able to plan workload, work forces, and facilities based on a firm commitment of 24 months of production rather than 12 months. Hiring programs and employee training programs would be able to be better synchronized with the production effort once the contractor is confident that production levels planned for the second year actually will occur. Such contractor confidence may result in earlier contractor investment in facilities.

DoD Experience:

In April 1985, the Department initiated a biennial planning cycle for the DoD Planning, Programing, and Budgeting System (PPBS), laying the groundwork for biennial budget formulation. The first biennial publication of the Defense Guidance occurred in January 1986 covering fiscal years 1988-1992. In June 1986, the Deputy Secretary announced that the Department would be shifting to a biennial PPBS cycle and that summer the program review process would assess the requirements for both FY 1988 and FY 1989.

Subsequently, authorization and appropriation requests for FY 1988 and FY 1989 for accounts in the national defense function were included in the President's FY 1988 Budget. Justification materials were forwarded to the Congress in support of the biennial budget request at the level of detail normally required by the Congress for its review and enactment of defense legislation.

However, total congressional support for this two-year budget was lacking. While the Senate Armed Services Committee reported a bill that authorized over half of the FY 1989 defense budget in addition to the FY 1988 program, the House Armed Services Committee proposed only an annual authorization bill. Although the resulting authorization legislation authorized nearly two-thirds of the FY 1989 request, that authorization was contingent on the enactment

of associated appropriations. Those appropriations were not forthcoming. Nonetheless, the support demonstrated by the authorization process constituted an important first step in the recognition of the biennial budgeting concept by the entire Congress.

The appropriations process for FY 1988 was chaotic, at best, and left little opportunity for a biennial defense budget. Concerns with the deficit and the threat of sizeable sequestrations under the provisions of the Gramm-Rudman-Hollings legislation contributed to the turmoil that ultimately led to three short-term Continuing Resolutions being enacted before final funding levels were agreed to in the bipartisan budget summit. Ironically, however, that bipartisan agreement resulted in the establishment of funding levels for both FY 1988 and FY 1989, in effect providing a biennial topline.

Still, the Congress did not enact a biennial FY 1988/FY 1989 defense budget as proposed. The Department, therefore, conducted an abbreviated budget review in order to formulate an amended FY 1989 budget that conformed to the budget summit topline. That the large reductions imposed on the defense program could be accommodated in such a short time was due, in large part, because of the activities that had been conducted within the Department during what had been envisioned as the "off-year" in the budget process. The implementation review permitted defense decisionmakers to better analyze how well we are meeting defense requirements in support of our military strategy. The budget community conducted an apportionment review, in lieu of a full-blown annual budget review, which provided additional insight into program execution. Specific issues in the area of program execution were explored with on-site visits to contractor facilities and government field offices. In general, our experience this first full cycle was positive and reaffirmed our commitment to biennial budgeting.

We are now well into the second biennial PPBS cycle. The Defense Guidance for the next internal defense planning exercise and the fiscal guidance for the POM were issued ahead of the annual schedule. The earlier planning and programming cycle thus far this year should facilitate the budget formulation efforts to be conducted this fall. Efforts are underway to fully incorporate biennial budget requirements into the DoD Budget Guidance Manual,

which serves as standing guidance for budget formulation and presentation within the Department. This effort, in effect, serves as the final phase in fully institutionalizing the biennial budget concept within the PPBS system.

Conclusion:

While there have been only tentative steps taken towards incorporating a biennial cycle in the congressional budget process for national defense functions, we have been pleased with the results of this first full two-year cycle within the Department. Experience revealed that there is nothing procedurally difficult about preparing and presenting a biennial budget. The Department was able to develop and present two-years' of data at the level of detail required by the congressional committees for review and enactment of defense legislation. There is no known reason why the Congress should not be able to enact authorizing and appropriating legislation for two fiscal years at a time.

It appears, then, that the major obstacle to full realization of biennial budgeting for national defense is a lack of commitment on the part of those in the Congress even though, ironically, the requirement for the President to submit a two-year defense budget results from congressional direction. Realistically, successful implementation of biennial budgeting means congressional committees will have to change their current focus from micromanagement of defense programs and line item directives to broader defense issues. True benefits and efficiencies cannot be achieved if the Congress continues to insist on line item authorizations and appropriations, which force inefficiencies on defense program execution.

Equally as important, we need to find a way to divorce national security funding levels from the debate on the deficit. The Department and the Congress must work together to re-establish a consensus on defense that reflects a national commitment to security needs. Biennial budgeting's overriding benefit of stability and predictability for defense funding and program levels clearly is preferable to the irregular funding patterns that have historically plagued defense. As the Secretary pointed out in his budget testimony, the Department would have been better off with zero growth since 1970 than to have experienced the roller coaster funding profiles during those years. Those of us in the Department

of Defense will continue to argue strongly for full implementation of a biennial budget for national defense functions and would encourage a move, ultimately, to an even longer framework.

Statement of
James L. Blum
Acting Director
Congressional Budget Office

Mr. Chairman, I am pleased to submit this statement to the Committee as a contribution to your hearing on budget reform.

THE NEED FOR BUDGET REFORM

A number of criticisms can be made about current budget procedures in the Congress. One criticism is that budget actions are not completed on time. Deadlines for completion of the budget resolution, consideration of authorizing legislation, and enactment of appropriation bills have frequently been missed. When these budget actions are late, agencies are prevented from carrying out programs most effectively.

Another complaint is that the Congress loses time by having to make repetitive decisions. It occasionally debates a program-level issue in a budget resolution, again in an authorizing bill, and then again in an appropriation bill. Further, reaching budget agreements between the President and the Congress often requires long negotiations and produces charges that each branch has been dealing in bad faith. Last but not least, deficits have simply been too high. Many believe that problems with the budget process have helped cause these deficits.

Without downplaying the importance of these criticisms, one should not forget that the Congressional Budget Act also produce many benefits. Because of the act, the Congress receives much better information about the interaction between the economy and the budget and about the probable costs of proposed bills. Control over direct spending has increased with the

reconciliation process. Most important, the status of the Congress in budgeting has been restored. Though its power of the purse had been threatened by the impoundment battles of the early 1970s, it is now an equal partner to the executive branch. The Congress is now fully capable of setting fiscal goals in budget resolutions, of accounting for its spending actions through the scorekeeping process, and of meeting budget targets through the various budget enforcement mechanisms. In fact, the Congress has made significant deficit reductions in recent years, though unforeseen economic and other factors have offset some of these savings.

Frustration with the process may be the result in part of these successes. The additional activities of preparing a budget resolution and a reconciliation bill, as well as carrying out scorekeeping and enforcement, make the Congress devote more time to budgeting. Unless the Congress is willing to surrender some of its constitutional power to the President, missed deadlines and other problems associated with a comprehensive process may be unavoidable.

The budget process has been difficult for another reason: the unquestionable need to reduce the deficit. A comprehensive process--one that puts everything on the table--is probably the only way of dealing with this problem. Reducing the deficit will require significant changes in spending and taxing policies, and long negotiations are typically needed before the Congress and the President agree to make such changes. As an alternative, the

Congress might adopt new procedures--as it did with the sequestration process--because of the expectation that negotiations will produce deficit reductions that are too small. Since the Congress is an organization that values its traditions, however, it is not very likely that radical changes such as the sequestration process will be introduced with ease.

Yet, changing the process could aid our efforts to reduce the deficit. If procedural changes would make it more likely that the Congress and the President would adopt budgets on time, without having to make unnecessary decisions and with greater comity between the branches, then perhaps it would be easier to focus on alternative budget plans.

BUDGET REFORM PROPOSALS

The Congressional Budget Office (CBO) does not support or oppose many of the budget process reforms that have been proposed. Our basic recommendation is that the Congress carefully study each proposal. Unfortunately, as the experience with the Congressional Budget Act shows, reforms often have unintended consequences. Hearings like this one will help the Congress avoid unpleasant surprises. The Committee has also published a useful evaluation of 13 budget reform proposals prepared by the Congressional Research Service.

Analyses of proposed reforms tend to reach several conclusions about their prospects. First, most proposed reforms imply significant changes to the roles of participants in the

process and, in some cases, losses of influence by these participants. These effects understandably tend to be controversial, which delays or prevents adoption of the reforms. Second, the likely effects of process changes on the deficit are typically small. Finally, in-depth analysis often shows that reforms present complexities that were unknown when the reform was first conceived.

To illustrate these points, I will briefly consider three proposed reforms: the line-item veto, biennial budgeting, and accounting reform.

Line-Item Veto

The line-item veto has been proposed by Presidents--and rejected by Congresses--for over a century. The reason is simple: the line-item veto would shift some of the appropriation power from the Congress to the President. The Congress has feared that by granting the President a line-item veto it would be forfeiting its right to allocate funds to individual programs and projects. This reluctance shows no sign of abating, making it unlikely that the line-item veto will be adopted in the near future.

The President currently has substantial influence on appropriation bills. A two-thirds majority of each house of the Congress must agree on a bill for the President to be unable to influence formally the contents of the bill through a veto. One reason appropriation bills have been delayed is that veto threats have caused the Congress to amend the contents of appropriation

bills so as to avoid vetoes.

The line-item veto would give the President the opportunity to break up the two-thirds majority. If the President vetoed individual projects, the Congress could protect the original appropriation bill only by voting to override each item veto. It would be difficult to maintain a two-thirds majority over a series of votes. Failure to do so would produce deficit reductions.

Of course, a President would have to prefer greater reductions in the deficit than the Congress for the line-item veto to have such an effect. Although many would argue that this is often the case, most of these observers would also agree that a President sometimes prefers to spend as much or more than does a Congress. This raises the prospect that a President would use the threat of a line-item veto to force Members of the Congress to vote for his preferred spending and not as a tool for aggregate deficit reduction.

Another argument raised against the line-item veto is that the projected savings from vetoed projects is small when compared with the magnitude of the deficit. The line-item veto would probably apply only to discretionary appropriations, which constitute less than half of the budget. Furthermore, most discretionary appropriations are devoted to defense and general government functions. Evidence from the states support this argument. Case study and quantitative analyses of their experiences with the line-item veto shows that the effect on

aggregate deficits has been small to nonexistent.¹

Other experiences from the states suggest that the line-item veto might increase conflict between the branches. State legislatures have sued governors over the extent of line-item veto powers, and the courts have been heavily involved in interpreting these powers. There are also reports that the item-veto has encouraged legislative irresponsibility, as legislatures have added items to appropriation bills with the hopes and expectations that the governor will veto the projects.

Biennial Budgeting

This Committee recently published a CBO staff working paper on biennial budgeting. That paper concluded that biennial budgeting offers the Congress an opportunity to shift some of its workload from budgeting and appropriating to doing more program reviews and oversight. Biennial appropriations could allow agencies to manage their programs somewhat more efficiently, which would produce budgetary savings. These savings, which would be difficult to quantify reliably, would certainly be small relative to the magnitude of the deficit. Biennial budgeting would probably not eliminate delays in adopting budgets, since the

¹ See Committee on Rules, House of Representatives, Item Veto: State Experience And Its Application To The Federal Situation (December 1986); Ronald C. Moe, Prospects For The Item Veto At The Federal Level: Lessons From The States, National Academy of Public Administration (February 1988); and Douglas Holtz-Eakin, "The Line Item Veto And Public Sector Budgets: Evidence From The States," National Bureau of Economic Research, Working Paper 2531 (March 1988).

stakes in a two-year budget would be higher than in an annual budget.

Like the line-item veto, biennial budgeting has been considered for years but never adopted. The major drawback from the perspective of many in the Congress is that the lack of an annual appropriation process could cause the Congress to lose some leverage with the executive branch. Policy riders on appropriation bills could only be used every other year, and poorly managed programs would have two years to spend appropriated funds rather than just one. On the other hand, the Congress might learn to use the authorizing and oversight processes to keep nearly the same level of influence, as well as having more time to gain a better understanding of problems and possible solutions.

In other words, the projected benefits of biennial budgeting would depend on the willingness of the Congress to change its behavior, and perhaps its committee structure (some committees could be left with nothing to do every other year). The Congress would also have to accept some additional uncertainty about economic forecasts and budget projections. Moreover, it would have to provide supplemental appropriations only in emergencies, or the workload savings from not budgeting every other year would be lost.

Improving Budgetary Accounting

A third reform, one not mentioned as frequently as the line-item veto and biennial budgeting, is the improvement of budgetary accounting. Twenty-one years ago, the President's Commission on Budget Concepts established the current framework for budgetary accounting. Although its principles have generally served us well, there is growing agreement that this budgetary accounting has significant faults. The government has the unfortunate ability to give the appearance of reducing the deficit without making any substantive changes in the underlying structural deficit. For example, loan asset sales that accelerate the receipt of cash payments are counted as deficit reductions, although the government's financial condition has not changed at all.

Accurately recognizing the likely costs of proposed spending will probably lead to a reduction in these costs over the long run. It is often difficult, however, to devise accepted accounting standards for government programs, as is illustrated by CBO's current research on methods of accounting for credit spending. CBO was required by the Balanced Budget Act Amendments of 1987 to evaluate the different credit reform proposals, and our report will be released this summer. Experts agree that the subsidy element of credit transactions is the proper measure for budgetary cost accounting, but they have yet to agree on how to measure loan subsidies. Over the years, we probably can devise an acceptable method of measuring subsidies, but other accounting

issues may be more difficult to solve. For example, many analysts are attracted in theory to capital budgeting for the federal government, but despair at the definitional problems that would be raised by having to construct a capital budget. For instance, should spending for missile procurement or for education grants be counted as capital expenditures? Clearly, further study of budgetary accounting is needed. The current accounting rules can be improved, but we have to be careful not to replace one set of imperfections with another.

CONCLUSION

Certain budget process reforms may offer ways of reducing conflict and meeting deadlines, but only if important assumptions turn out to be correct. However promising reforms may be as a way of solving procedural problems, they will not reduce the deficit by much. Significant policy changes are needed to deal with the deficit problem. In the upcoming year, the Congress will have numerous menus of policy changes to choose from, including President Reagan's last budget, the incoming President's recommendations, the suggestions of the National Economic Commission, and the budget reductions volume of our annual report. We look forward to helping the Congress analyze these options.

Testimony

on

Constitutional Amendment to Require a Balanced Budget

to be delivered by

John J. Rhodes, Co-Chairman

on behalf of the

Committee For A Responsible Federal Budget*

before the Committee on The Judiciary

Subcommittee on Monopolies and Commercial Law

October 15, 1987

*The Committee For A Responsible Federal Budget is a bipartisan nonprofit organization formed to educate the public on the federal budget and on the federal budget process.

The Committee is Co-Chaired by Robert M. Giaimo and John J. Rhodes. Roy L. Ash, Thomas L. Ashley, Richard Bolling, Carol G. Cox, James L. Ferguson, John H. Filer, Peter M. Flanigan, James R. Jones, Arthur Levitt, Jr., James Lynn, James T. McIntyre, Jr., W. Henson Moore, Howard Moskof, Edmund S. Muskie, Rudolph G. Penner, Peter G. Peterson, Leland S. Prussia, Alice M. Rielin, Elmer Staats, David A. Stockmar, Robert Strauss are on the Board of Directors.

Mr. Chairman, Mr. Fish, Members of the Committee, I am very pleased to take this opportunity to share with you my own views and those of the Committee for a Responsible Federal Budget on the subject of a constitutional amendment to require a balanced budget. Mr. Chairman, we oppose constitutional approaches to budget balance generally, and H.J. Res. 321 specifically.

Do not misunderstand. I, and the Committee I represent, believe in budget balance. We believe that this Administration and this Congress have put too high a priority on specific spending programs and tax policies, and too low a priority on balancing the budget. We believe that the norm of budget balance served this country well for nearly two hundred years. We are concerned that you and the President have abandoned that norm, without asking yourselves: what can or should take its place?

Our Committee hosted a symposium on the norm of budget balance in New York, in January, 1986. We have included a copy of the compendium of that meeting with my testimony today for your information.

We do not believe that trying to enshrine the goal of budget balance in the constitution is in the long term interest of the United States. Why not?

First, balanced budget constitutional amendments are directed toward the wrong target. Our "Budgets" really are only plans. They contain no spending and no revenues. A "Balanced Budget," therefore, cannot really guarantee that outlays will be equal to or less than revenues.

Second, a balanced budget constitutional amendment will not work. Either the requirement for budget balance must be too rigid to accommodate other imperatives; or the mechanism to suspend the requirement for budget balance in times of war, economic or other emergencies, must permit Congress and the President to escape the intended constitutional restraint.

Third, any constitutional requirement for budget balance invites judicial intervention in determining appropriate (in this case constitutional) fiscal policy. Our federal judges are not elected. They are not supposed to make policy. At best, such judicial intervention could lead to confusion; at worst, it could cause a major constitutional crisis.

Fourth, the word "budget" is not a term of art. It means what any Congress decides it means, at any point in time. Congress can, and does, redefine the term to mean whatever they want it to mean.

We would advise you: Physician heal thyself. Congress' own budget process is far from perfect. As one of the drafters of that process, I can tell you we who wrote the law knew it was flawed. We did the best we could at that time (1974), considering the power of the opposition which had to be mollified.

Congress has had more than ten years' experience with its budget process. You should put that experience to use, perfect your own budget decision-making mechanisms. Stop looking for quick and easy solutions. Quit looking for some higher authority to take this burden from your shoulders. This is your job. It is high time you lead, as you promised your constituents you would when you ran for office.

For this Congress and this President, who together have more than doubled the national debt in the last five years, to enact a balanced budget constitutional amendment would be ludicrous. Constitutional amendments don't balance budgets. To balance the budget, Congress and the President must agree either to cut spending and/or raise revenues. Better you should spend your time debating the hard choices needed to put our nation's fiscal policy back on a reasonable, responsible, course than to continue this discussion of a seemingly painless panacea.

The largest stumbling block in the way of budget balance is the irresistible tendency of politicians to take cheap shots at one another. Republicans live with the memory of their losses in 1982, when we may have lost 20 House seats over the social security issue. Democrats remember the Guy Vander Jagt letter on TEFRA. They continue to be concerned that the President will kill them over any tax increase. The point is, this tendency is not limited to competition between Congress and the President. Members of each party can't seem to resist any opportunity to get one another -- especially as elections grow nearer.

A constitutional amendment won't change this tendency. What we really need, if we are to put our budget house in order, is a "treaty," in which everyone agrees no one will take political advantage of the very hard choices which will have to be considered -- and ultimately included in any package to move the budget back toward balance.

Balanced Budget Constitutional Amendments Aim at the Wrong Legislation.

What is the federal budget? Is it the document titled, "Budget of the United States Government," which the President submits early each year? Is it the Congressional Budget Resolution? Is it the "Plan," described in the most recently proposed balanced budget constitutional amendments?

None of these contain any spending or tax legislation. Absent legislation to implement these plans, none of the above can increase or decrease federal spending or revenues one red dime. None of these, therefore, can produce budget balance.

Even when Congress and the President agree to enact all the policies assumed in the budget, the deficit still may exceed the amount contained in your plan by several billion dollars.

7. The table included at "Attachment I" with this testimony makes this point. It illustrates the dramatic differences between the projections contained in congressional budget resolutions and actual budget outcomes. Please note: economic and technical estimates account for most of the differences. Failure to enact the policies assumed in various budget resolutions accounts for a much smaller share of the problem.

It is an exercise in futility to limit constitutionally the contents of the "budget," or the "plan," as the drafters of the amendment before you choose to call the blueprint for fiscal policy. Surely, there must be something else proponents of the amendment hope to accomplish. What is their objective?

Do they want to make it harder for Congress to spend money? Perhaps they should propose a constitutional requirement for super-majority votes to pass new spending legislation. Alan Greenspan argued for years for just such an amendment. I doubt, however, that a majority of Members of the House would support it.

Is it really their agenda to limit taxes? The amendment before you surely would do that. But if that is the objective of proponents of this amendment, let them say so. You and I should not join in the pretense that this amendment somehow, magically, would produce a balanced budget.

If you aim to balance actual federal outlays and revenues, you must turn your attention to real spending and revenue legislation -- and to rules and procedures for the consideration of such laws. Later in my testimony, I shall summarize for you some of our ideas for changes in the congressional budget process -- changes which could help you achieve this goal.

Balanced Budget Amendments are Unworkable

Almost everyone agrees, there are times when the federal budget need not -- should not -- be in balance.

Should we have balanced the budget during World War II? Of course not. Every proposed balanced budget amendment makes an exception when the country is at war.

Should we abandon the federal government's role in economic stabilization? Evidently not. Most proposed amendments would permit the President and Congress to suspend the balanced budget requirement in times of economic emergency.

What about famine? If millions of Americans were starving, should we suspend the constitutional requirement for budget balance?

Shall we list in the Constitution all the instances in which we think we may want to suspend the requirement for budget balance? What if we overlook something important? Don't we need a catch all provision, which would permit future Congresses and future Presidents to decide whether the "emergencies" they face are so compelling that the constitutional requirement for budget balance should be suspended?

Once we permit Congress and the President to decide whether current circumstances justify suspension of any constitutional requirement for budget balance, who believes the constitutional requirement will govern? Political reality would prevail, just as it does today.

Take a lesson from your recent Gramm-Rudman-Hollings experience. Faced with "politically unrealistic" statutory budget restraints, what did you do? You changed the statute. You could not change the Constitution so easily, thus avoidance behavior in the face of constitutional constraint would have to be more subtle -- and more dangerous to the fundamental underpinnings of our entire system of government.

Please consider very carefully what you do, before you write into the Constitution any requirement Congress and the President would be tempted to suspend on a regular basis.

Judicial Intervention in Federal Fiscal Policy Would be Dangerous

Judges are not supposed to legislate. They are supposed to interpret the law. Where there is a clear constitutional mandate, however, and where the legislature and/or the executive acts in an unconstitutional manner, the judicial branch must intervene.

We have seen this phenomenon in redistricting cases. Often the courts have imposed specific redistricting plans. The courts have not forced legislatures to act constitutionally. The courts have substituted their judgment for that of the legislative branch.

No matter how you feel about the outcome of any specific court case, do any of you want to see the federal courts decide what the federal budget should be? Even if you can get past the question of standing, what would be the remedy if the courts decided the federal budget for a given year was unconstitutional?

Would the courts impose Gramm-Rudman-Hollings-type cuts, reducing federal spending across-the-board? Would they cancel the last appropriations bill passed in a given year -- because it unbalanced the budget? Most would agree the court could not impose new taxes, but could the court cancel a tax cut -- if the tax cut unbalanced the budget?

Today Judge Robert Bork is at the center of a political storm, because many see him as the embodiment of the new "conservative" movement in this country. You would assume he would support this amendment. Not so. Judge Bork has warned (in an article in The Wall Street Journal April 4, 1979): "The prospect may be for nightmare litigation that would be damaging to both the judiciary and to the budgetary process."

Judge Bork points out that proponents of the balanced budget amendment often reply, when asked how it actually would work, saying essentially: "We don't do windows;" but, Judge Bork cautions, "Judges do do windows."

The message is clear. Do we want to turn over to the judiciary this crucial role in federal fiscal policy? I think not.

Rudy Pinner has voiced a variation on this theme. Rudy opposes the amendment; but he says, as an economist, often he is tempted to support it.

Just think, says Rudy, the chief economist of the U.S. Supreme Court would decide whether the economic forecast underlying a budget is "right" -- and therefore, whether the budget is constitutional. That is real power, and that is absurd.

It is not too strong to say: the power to tax and to spend public funds, the power to set fiscal policy, must remain in the hands of elected officials. Transferring power in this area to the judiciary, as this amendment could do, is unwise and could be downright dangerous.

Conflicting Priorities and Confusing Process

As I said at the beginning of my remarks, Physician heal thyself. The budget deficit problem we face today results from conflicting priorities, and is compounded by an imperfect budget process.

Almost everybody in public life subscribes to the goal of budget balance. Even those in my party who still believe tax cuts, supply side economics, and economic growth will solve our budget deficit problem, believe in the importance of budget balance.

The problem is that almost everyone in public life places higher priority on something else other than they do on budget balance.

The President puts tax cuts and his defense build-up ahead of budget balance. Many in Congress prefer deficit spending to further cuts in programs which benefit their constituents. We will continue to run record high deficits, until our elected leaders put budget balance higher on their list of priorities -- with or without a constitutional amendment.

Balancing the budget is not analytically a difficult problem. It is a difficult problem politically. The answer really is simple. We must decide what we want from government, and what we can do without. Once we decide what we want from our government, we must figure out how to pay for it -- not just pass on the bills to future generations. If we cannot figure out how to pay for what we want, we must go back and prune our list of wants, until we get to a level of government for which we are willing to pay.

The answer may be simple. The compromises along the way are not. No mechanical device -- constitutional, statutory or regulatory -- can make those compromises easy. I have told you many of the reasons we believe a constitutional amendment is dangerous. Let me tell you some things you could do, short of amending the Constitution, which we believe would make your task easier.

The congressional budget process takes too long, it is redundant and confusing. The process can be improved: first, by encouraging Congress to act in a timely fashion on a more realistic blueprint for fiscal policy; and second, by improving enforcement of budget decisions once they are enacted.

Timely Congressional Action on Realistic Budget Blueprints

Congress needs incentives to act. Certainly, Congress needs incentives to act in a timely fashion on anything as unsatisfying as the budget.

There should be a penalty, if Congress fails to pass the budget in a timely fashion.

I have suggested, if Congress does not pass a budget on time, you could deem the President's budget to have been enacted, and use it as the basis of Congressional enforcement unless and until Congress adopts a budget.

Now that you have Gramm-Rudman-Hollings, and its requirement for across-the-board cuts if Congress and the President fail to agree on an alternative to achieve the deficit limits in the law, you could substitute the sequestration budget for the President's budget in my earlier proposal.

In either event, I am suggesting seriously that Congress should deem some budget to have been adopted by the statutory deadline. You should give committees 302 allocations based on the budget you deem to have been adopted. You should enforce points of order against legislation which would exceed committee allocations, based on the budget you have deemed adopted. If you did so, Congress would have a real incentive to act on their own version of the budget on time.

Speaking of Committee allocations only points out how important it is for Congress to act on the budget in a timely fashion. The budget is the blueprint. How can you hope to act on other legislation in a timely fashion -- how can you break the recent pattern of governance by continuing resolution -- until and unless you insist that you will adopt the blueprint on time?

The blueprint must be real. We pointed earlier to the pattern of deviation from congressional budget resolutions in actual budget outcomes. Much of this deviation is due to economics and technical estimates. There are a number of possibilities for narrowing the scope of difficulties posed by these two factors. Let me mention only three.

The current policy baseline was a very useful concept in periods of relatively high inflation. Today, I am prepared to argue, it is confusing.

If it were not so confusing, why did you invent a new baseline concept for the purposes of sequestration under Gramm-Rudman-Hollings?

The CBO February estimate of current policy spending for FY 88 was \$61.3 billion higher than their estimate of FY 87 outlays. For at least seven years, Congress and the President have talked of "cutting spending" to cut the deficit. When was the last time anyone proposed to cut spending below the previous year's levels? Perhaps we should revert to an old fashioned idea: compare our budget decisions for next year to what we actually will spend this year. Measure increases and decreases from what we actually will spend in the current year -- and perhaps more people will understand what we really are about.

If that is too simple, and many will say it is, then at least we must do something about our tendency toward rosy economic assumptions.

My Republican colleagues and I fought, when Congress considered Humphrey-Hawkins, to keep the House from voting on economic assumptions. We understood, even then, how hard it would be to vote for higher, rather than lower, inflation or unemployment. We did not understand, then, the temptation we would face to vote for higher growth figures -- to make future deficits look smaller than they likely would turn out to be.

We do our economist friends no disservice when we point out there always is a range of forecasts, and within the range it is hard to argue who is -- or even who has been -- most accurate.

It is possible, however, for Congress to decide whether you would choose to err on the side of restraint or stimulus, when you make your initial budget decisions. If you prefer smaller deficits, choose somewhat more pessimistic economic projections. If you want more stimulus, choose more optimistic assumptions. This would tend to produce deficits moving in the direction you want. It would not attempt to judge who is right and who is wrong about the future. We could acknowledge at the outset that we are likely to be wrong, and opt for a set of economic assumptions likely to produce budget outcomes consistent with our goals.

This is only the tip of the iceberg. Unfortunately, changing the incentives in our budget decision-making processes -- away from buy now pay later, and toward budget balance -- is not as simple or as sexy as a constitutional amendment. There is a long list of changes we could recommend, including fundamental changes in Congress' own intra-institutional arrangements. For those of you who are interested, I have included my testimony before the Government Operations Committee, earlier this year (Attachment II). I recommend to you, also, Alice Rivlin's article, "The Need for a Better Budget Process," (Attachment III).

In closing, let me say I have included a "Simple Problem" devised by the staff of the Committee for a Responsible Federal Budget. This "Simple Problem" illustrates the very real difficulty of implementing the proposed constitutional amendment.

This is not facetious, nor is it prepared in jest. We will have a new President again in 1989. The new President will face deficits much larger than the deficits Ronald Reagan faced when first he took office. The Senate -- even the House -- conceivably could change hands. Please do not vote for a constitutional amendment to require a balanced budget, unless you can look at this "Simple Problem," envision how a similar set of circumstances would play out in the future, and feel comfortable with the result.

Date	SIMPLE PROBLEM	Deficit/Surplus (\$ in billions)
<u>Steps in the Budget Process</u>		
May 1980	Congress adopts First Concurrent Resolution on the budget for FY1981. Congress and the president hail passage of the first "balanced budget" in more than a decade.	+ \$ 0.5
November 1980	Congress adopts Second Concurrent Resolution on the Budget for FY 1981, which on its face recognized there would be a deficit.	- \$27.4
	Senators Bellmon and Domenici argue that the deficit and spending are understated in the second resolution largely because of changes in economic assumptions -- and that the Senate should make additional cuts.	
	The Senate rejects the Bellmon/Domenici argument.	
January 1981	President Carter's FY 1982 Budget predicts an even higher FY 1981 deficit.	- \$55.2
May 1981	Congress adopts the First Concurrent Resolution on the Budget for FY 1982. They revise the FY 1981 Budget resolution and increase their deficit estimate for FY 1981 because actual spending is in excess of the Resolution which already is seven months gone.	- \$55.1
November 1981	Actual FY 1981 deficit is announced.	- \$54.9
	Actual outlays in FY 1981 were \$40.0 billion higher than the amounts contained in the First Concurrent resolution on the Budget, which had been adopted in May 1980.	

If the balanced budget constitutional amendment had been the law of the land in 1980, who should have determined that the budget really was not in balance? When should that determination have been made? Who should have done what about it?

In May 1980, when Congress adopted the First Concurrent Resolution on the Budget for 1981, many skeptics argued that the economic assumptions and technical estimates were overly optimistic, and that the budget really was not in balance. The President and Congress agreed that the budget was balanced. Should some "higher authority" have decided the issue? If so, whom? Should someone have been empowered to sue? Should the courts have decided the issue?

In November 1980, Congress and the President acknowledged that the budget was out of balance -- though the Congressional Budget Resolution then adopted understated the actual deficit by nearly \$30 billion.

Congress could have "assumed" additional spending cuts and/or higher revenues would materialize, and/or they could have jiggled the economic assumptions underlying the budget, and forecasted budget balance. The ranking Republican on the Senate Budget Committee, and the soon-to-be Chairman of that Committee, argued at the time that the budget projections were unduly optimistic.

Under the amendment, could/should they have gone to court? If the court had agreed with Senators Bellmon and Domenici, what remedy would the court have prescribed.

In November 1980, the incumbent President and the incumbent Senate both were "lame ducks." Democrats had lost the election. Should someone have compelled the Democratic President and the Democratically controlled Congress to "balance the budget?" Should that task have been left to the newly elected President and the newly divided Congress, including the new Republican majority in the Senate?

If FY 1981, federal spending totaled \$678.2 billion. Eliminating the deficit that year would have required a change in the fiscal policy equal to 8% of total government outlay. Is it reasonable or wise to require a political party which has just lost a national election to implement such changes, arguably on the basis of policies and priorities the electorate has rejected?

On the other hand, and again using our example, balancing the budget several months after the fiscal year had begun was a nearly impossible task. In our example, Congress and the President would have faced spending cuts and/or tax increases equal to 20% of total outlays for the balance of FY 1981, if they had been compelled to act in May of 1981 to balance the FY 1981 budget.

The balanced budget amendment says that Congress and the President shall agree to balanced budgets, and that they shall ensure that actual spending and revenues conform to the projections for budget balance.

The amendment does not tell us who will determine whether the budget is in balance, when that determination shall be made -- much less how the decision will be made whether and when actual spending and revenues conform to budget projections -- and by whom that decision will be made.

The amendment does not tell us, in our example, which Congress and which President are responsible for balancing the budget. Logic suggests that the incumbents bear responsibility. If someone determines the budget is out of balance soon after the inauguration of a new President and a new Congress, however, must the newly elected officials remedy the problem they inherited in the current fiscal year?

These are serious questions. The entire House of Representatives, and one-third of the Senate, is elected every two years. A new President is elected or reelected every four years. Budgeting is the quintessential political activity. The Constitution cannot dictate a budget-decision-making process which will not mesh with our electoral politics.

ATTACHMENT 1

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Memo to: Board and Members
From: Carol G. Cox and
Susan Clark Joy
Date: March 4, 1987

Subject: Baseline Budget Estimates and the Federal Budgetary Crisis

There is attached an analysis of the current policy baseline budget projections. We are very concerned that the baseline projections tend to understate the difficulty Congress and the Administration face as they attempt to cut the deficit to the GRH limits -- or even to move the budget back toward balance anytime in the reasonable future.

This is not a criticism of the Congressional Budget Office and/or the Office of Management and Budget. We reference the CBO estimates, because they are the less optimistic of the two. Even the CBO estimates, however, are based on conventions which tend to compound and exaggerate the effect in future years of recent spending restraint.

This analysis suggests Congress and the President, the media and all of us outside government concerned with budget issues are approaching this year's budget debate wearing rose colored glasses.

The choices to move the budget back toward balance, taking the CBO baseline as the point of departure, appear very difficult. Many in Congress have suggested that, using the CBO baseline, Congress and the President cannot reach agreement on a package to cut the deficit to the GRH limit in FY88.

If our analysis of the baseline estimates is correct, the problem is much greater -- the choices are much more difficult than they appear. Does this mean that Congress and the Administration should give up on deficit reduction? No. A bipartisan agreement to cut the deficit as much and as soon as possible is truly critical, especially if the problem is worse than the baseline makes it appear.

The Budget Outlook
Congressional Budget Office Estimates
(\$ in Billions - totals may not add due to rounding)

	1986	1987	Projections				
	Actual	Base	1988	1989	1990	1991	1992
Revenues	769	834	901	962	1051	1139	1223
Outlays	990	1010	1071	1126	1186	1249	1306
Deficit	221	176	171	164	137	110	84
GRH Limits	172	144	106	72	36	-0-	---
Debt Held by the Public	1746	1913	2081	2244	2378	2485	2567

	As a Percent of GNP						
	1985	1987	1988	1989	1990	1991	1992
Revenues	18.5	19.0	19.2	19.1	19.4	19.7	19.8
Outlays	23.8	23.0	22.6	22.4	22.0	21.6	21.1
Deficit	5.3	4.0	3.6	3.3	2.5	1.9	1.4
Debt Held by the Public	41.9	43.5	44.3	44.6	44.0	42.9	41.5

Reference: GNP
(\$ in billions) 4163 4399 4695 5033 5406 5792 6186

SOURCE: Congressional Budget Office, The Economic and Budget Outlook, January 1987. Projections for FY87 from An Analysis of the President's Budget for Fiscal Year 1988, February 1987, where CBO published their updated baseline.

There is something unreal about these projections: They assume 10 years' uninterrupted economic growth 1982 -- 1992. Revenue projections grow with the economy -- by nearly 59% between 1985 and 1992; but spending projections grow only 32% over the same period.

The projections of continued restraint in non-defense spending are unbelievable. Consider the following historical data and projections:

	Percent of GNP		
	1976	1985	1992
Total Non-Defense Outlays	16.6	17.0	15.5
Social Security Trust Fund Outlays (Medicare and GASDI)	5.1	6.8	6.8
Agriculture	0.3	0.7	0.4
Net Interest Outlays	1.6	3.4	2.5
Remaining Non-Defense Discretionary	9.6	6.1	5.8

Source: Historical Tables, Budget of the United States Government Fiscal Year 1987; and CBO Baseline projections for FY88.

- The CBO baseline concept provided a pretty accurate basis for predicting the future when appropriations were growing more or less with the economy.

In the last few years, however, there has been substantial restraint in non-defense discretionary spending. The baseline assumes that restraint will continue -- and the compounded effect of projecting restraint year after year produces what I believe really is a very distorted picture of what the budget will look.

Between 1975 and 1986 total non-defense outlays remained about constant as a percent of GNP; but spending for social security and interest increased; so spending for all other domestic programs declined by an amount equal to 2.5% of GNP.

These projections assume total non-defense outlays will decline by 2.5% of GNP between 1986 and 1992; and that outlays for all domestic programs except social security, medicare and interest will decline by a further 1.1% of GNP.

That is looking only at the non-defense side of the budget. These projections also assume 0% real growth for defense throughout the forecast period.

- CBO projects that the deficit will decline 62% on a current policy basis by 1992. Therefore interest costs are projected to decline substantially.

If defense goes up -- if non-defense discretionary spending does not continue to fall -- if we suffer an economic downturn -- if interest rates rise -- absent major policy change the deficit and interest costs will be substantially higher than the CBO projections.

Unless we cut spending and raise taxes, frankly, I think that is a far more likely outcome.

The Deficit as a Percent of Net Private Savings
(\$ in billions)

FY86* Deficit	Net Savings			Deficit as % of Net Savings	
	Domestic	Foreign	Total	Domestic	Total
\$221	\$275.3	\$130.5	\$405.8	80.3	54.5

* FY86 is the most recent year for which data are available.

Source: The Federal Reserve.

The table above illustrates two things: the extent to which the Federal deficit diverts capital away from private investment which could lead to higher productivity and increased competitiveness; and the extent to which we are dependent on foreign investment to finance these record high deficits at relatively reasonable rates of interest.

ATTACHMENT II

TESTIMONY

by

John J. Rhodes

on behalf of

"The Committee For A Responsible Federal Budget"

to be delivered before

The Committee on Government Operations

United States House of Representatives

March 12, 1986

- * The Committee For A Responsible Federal Budget is a bipartisan private nonprofit organization formed to support and strengthen the federal budget process.

The Committee is Co-Chaired by Robert N. Giaimo and John J. Rhodes. Thomas L. Ashley, Roy L. Ash, Richard Bolling, Carol G. Cox, James L. Ferguson, John H. Filer, Alan Greenspan, James R. Jones, Arthur Levitt, Jr., James Lynn, James T. McIntyre, Jr., W. Henson Moore, Howard F. Moskof, Edmund S. Muskie, Rudolph B. Penner, Peter G. Peterson, Leland E. Prussia, Alice M. Rivlin, Elmer Staats, David A. Stockman, Robert Strauss are on the Board of Directors.

TestimonyIntroduction

Mr. Chairman, Mr. Vice Chairman, Members of the Committee. We go back a long way. The Chairman and I came to Congress together 37 years ago. The Vice Chairman and I served together for twenty years. My son is now your colleague. In our lifetimes, Congress has wrought a revolution in its budget process. That revolution was necessary. It has been surprisingly successful.

I am here on behalf of the Committee for a Responsible Federal Budget. I am the Republican Co-Chairman of the Committee. Bob Giannini is our Democratic Co-Chairman. Bob would like to be here. Unfortunately, he had another commitment. Our Vice President, Susan Clark Joy, is here with me today. You have, in my prepared text before you, a full list of our Directors. They have included all the former Chairmen of the House and Senate Budget Committees. (The late Al Ullman was a charter member of our Board. Brock Adams and Henry Bellmon left the Board this year, when they returned to public office.) They also include the former JCB and CBO Directors and leaders of the business community. I want to share with you our thoughts, based on our collective experience.

Priorities: #1 Cut the Deficit

We recommend some budget process changes to you which we hope will be accomplished. But we recognize that Congress and the President may have all you can do to solve the present deficit problem facing the nation. You have made some progress. Still you face a monumental task, the importance of which cannot be overstated, and which must be number one on your priority list. In other words, the process is a problem, but the problem is the problem itself -- the deficit.

Our staff analysis of the budget outlook is included as an appendix to my prepared testimony. In our view, the CBO baseline deficit projections are optimistic in the extreme.

Both CBO and JEB project the economy will continue to grow through 1992 -- ten uninterrupted years of growth. CBO, which is less optimistic than JEB, projects revenues will grow by 55% by 1992. Their spending projections increase 32% over the same period. Assume for a minute we do enjoy ten years of economic recovery. Assume, however, that spending increases as much as but no more than revenues: The deficit in 1992 would exceed \$200 billion.

Our purpose here is not to criticize the CBO. Their projections are based on conventions which worked well to predict the future when spending, revenues, and the economy were growing at about the same rate. The past few years, however, have seen substantial restraint in non-defense discretionary spending. The baseline assumes that restraint will continue. We hope they are right, but we fear the CBO methodology compounds and exaggerates the effects of recent spending restraint unrealistically.

Why this numbers lecture in testimony about the budget process? We are concerned that recent projections of declining deficits have decreased Congress' sense of urgency about the need to bring the federal deficit under control. We are concerned that spending restraint does not necessarily breed more spending restraint. On the contrary, there is tremendous pressure to increase spending today. We are concerned that there will remain indefinitely a fundamental imbalance between federal spending and federal revenues.

The deficit problem remains very serious. The budget deficit is a major cause of the trade deficit. Federal intrusion into the credit markets to fund its deficit spending amounted to over 50% of net private savings in this country in 1986. The competition for credit created by massive federal borrowing places a premium on capital and has kept real interest rates high -- even though nominal interest rates have fallen dramatically in the last six years.

High real interest rates and the competition for available capital hinders our domestic industry in the retooling and innovation necessary to maintain competitiveness with foreign imports. It hurts the farmer, whose narrow margins of profit are eroded by the high cost of borrowing for seed and equipment. Further, high real interest rates have inflated the value of the dollar on international exchange markets -- hurting US export sales overseas.

Solving the deficit problem will not solve all our economic problems, but it is a necessary first step toward longterm prosperity and increased competitiveness in a global economy.

The deficit problem will result in economic disaster, if Congress and the President do not agree on a plan to move the budget back toward balance before our economy suffers another recession. Sooner or later there will be another recession. You cannot repeal the business cycle. Deficit reduction must be your priority. You have only so much time.

The Congressional Budget Process: An Historical Perspective

Remember what the world was like before the Congressional Budget Act. The President submitted his budget to Congress. We took it apart. We sent revenue proposals to the Ways and Means Committee. We divided up the spending proposals among thirteen sub-committees of Appropriations and the entitlement committees. The whole budget never came together again. We did not know until sometime after the end of the fiscal year the amount of the deficit (or surplus). Congress had no effective mechanism to formulate an alternative to the President's budget priorities.

From 1967 to 1977 relatively uncontrollable outlays increased from 59% to 77% of total federal spending. Today, relatively uncontrollable spending remains 77% of total outlays. We were alarmed in the mid-seventies because Congress had lost control over Federal spending. We have not really regained control since the Budget Act, but neither have we lost any more ground. No new large entitlement programs have been enacted. That is a major success.

The Congressional Budget Act and process are the result of compromise: compromise on executive impoundment authority; compromise to protect the turf of existing congressional committees; compromises between those who believe the budget process should ensure budget balance and those who believe that the budget process should be neutral as to the outcome of each year's budget

.....

The budget process is not perfect. From the beginning, we knew it had flaws, but it works far better than many of us who wrote the law thought it would. Your Committee has jurisdiction over Title X -- the Impoundment title -- of the Congressional Budget Act. I will talk about impoundment today. I also want to address a broader agenda. This is the first opportunity we have had to share our ideas on the budget process with Congress since late 1985, when you were considering Gramm-Rudman-Hollings.

Gramm-Rudman-Hollings (GRH)

In 1985, we were not enthusiastic about GRH. No process can resolve political differences over public priorities.

Some elements of GRH have worked better than we expected. Bottom line deficit limits have had a salutary effect. Though you may not achieve the goal, attention is focused on the bottom line. The requirement that budget, reconciliation, spending and tax amendments be deficit neutral has worked well. Enforcement of Congressional budget decisions at the level of committee and sub-committee allocations was long overdue.

Sequestration per se never was a good idea. Automatic across-the-board cuts are the antithesis of the priority setting which should be at the heart of an effective budget process. Congress and the President need incentives to compromise differences over priorities. If we believed sequestration would produce that result, we would support a new sequester process which would meet constitutional objectives. It may come to that. But we shudder to think what would result, even from cuts across the board in all federal programs, to balance the budget. If you include defense and social security in a sequester process, they will take the biggest dollar hits. They are by far the biggest federal programs. If you exempt any program in any way from any sequester process, the axe falls that much heavier on everything left to cut.

Balanced Budget Constitutional Amendment

We oppose a balanced budget constitutional amendment. We believe the budget should be in balance over a reasonable time -- perhaps over the business cycle. Deficits sometimes are necessary: to fight wars, to alleviate depressions, famines or other emergencies. We also should run surpluses at times, so our accounts eventually balance out.

The Federal budget is very sensitive to economic assumptions. Look at the difference between Administration and Congressional Budget Office estimates of the deficit and the cuts needed to achieve the ~~SE~~ goals this year. No constitutional constraint successfully could address these realities. Balanced budget amendments could do nothing constitutionally to constrain spending or tax policy. Budget resolutions contain no spending or taxes. Budget resolutions are plans for spending and taxing which must be legislatively enacted. It is the budget resolution -- the plan -- that the balanced budget constitutional amendment addresses. We need politically effective incentives to balance spending and revenues, not a balanced budget amendment. What we really need is a majority of Members of Congress who will put budget balance at or near the top of their personal list of priorities.

Line Item Veto

Every President since Eisenhower has asked Congress for line item veto. You are not going to give any President that power, and we believe you should not. The recent trend toward large continuing resolutions and omnibus appropriations actions, however, argues persuasively for a process to permit the President to single out spending he believes is unnecessary or excessive -- and ensure Congress will vote on proposed rescissions.

We support Senator Quayle's proposal. It would alter existing law with regard to rescissions in one important respect: any Member of Congress could force a vote in either House on any proposed rescission. If Congress agreed with the proposed rescission, by a simple majority vote in both Houses, one assumes the President would sign the legislation and it would become law. If a proposed rescission failed, by simple majority vote in either House, it would die. That is the bottom line effect of the Quayle proposal. It is a modest and positive change, worthy of your serious consideration.

Credit Reform

You should consider carefully the credit reform proposed by the President in his budget this year which would charge the cost of credit -- the present value of the subsidy provided to borrowers -- to any agency making or guaranteeing loans. We have succeeded in restraining the growth of new entitlements, but loan and loan guarantee programs have grown at an alarming rate. Some system is sorely needed to disclose and to force us to budget for the subsidy value of federal lending activities and to consider more closely the allocation of resources between credit and other spending.

There are alternatives to the President's proposal for credit reform. You may prefer an alternative mechanism to the President's proposed "market pricing" strategy to identify and account for the subsidy cost of loan and loan guarantee programs. But the cost of credit programs should be put on an expenditure basis equivalent to other Federal spending. Identifying the subsidy cost of federal loan programs would also enable informed debate and decision-making about the most appropriate means of delivering federal benefits (credit vs. noncredit expenditure programs). Whatever process you prefer to achieve these objectives, however, you should put credit reform high on your process reform agenda.

Our federal budget process would be improved greatly by our developing a system to compare the costs/benefits of direct spending, loans and loan guarantees, and tax incentives to achieve a stated public policy objective. Cross-cut analysis, of course, would require that we know the cost as well as the benefit of each possible approach. We know the cost of direct spending and tax incentives. Now we need to account for the cost of credit activities.

Incentives for Action

Congress needs a compelling incentive to adopt a budget on time. It is a mistake to permit Congress to consider spending and/or tax legislation before you adopt a budget. The §311 point of order is meaningless if there are no §302 allocations. The §302 allocations are your yardstick, to ensure Congress lives within its own budget. The §311 point of order is the basic tool, to permit Congress to enforce your budget. There can be no yardstick, no effective enforcement mechanism until Congress adopts a budget resolution.

But Congress often does not want to vote on a budget. Budget votes can be tough. Experience has taught us: voting for a budget can prove so difficult. Congressmen and Senators are tempted to delay. This delay undermines your own budget process. You need a mechanism to force yourselves to act.

If Congress does not adopt a budget by the deadline in the law, you could deem the President's budget to have been adopted and issue §302 allocations on that basis; or you could deem the most recently agreed to congressional budget resolution to have been adopted for the upcoming year and issue §302 allocations on that basis.

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If necessary you could reduce either of the above budgets pro rata, using the sequester formula contained in GRH, to achieve the target deficit in the law. In either case, Committees and subcommittees would have \$302 allocations, the §311 point of order would apply, and the budget would be enforceable. No one would like it, but that is the point. Congress would have a compelling reason to pass a budget on time, because the alternative would be unthinkable to most members.

Biennial Budgeting

We support the concept of biennial budgeting. Everyone in government spends too much time every year going over the entire budget. A biennial budget and appropriations process would save time. It would free up time for oversight, program evaluation and careful consideration of authorizing legislation.

A biennial budget cycle makes no sense unless you also move to a biennial process for the consideration of appropriations and revenue legislation. Therein lies the difficulty: how to ensure the executive and the legislature do not spend non-budget years revisiting the budget, spending and tax legislation?

Many beneficial changes in the budget process have come about through evolution. We tried things out, then we codified changes that worked. We think you should try biennial budgeting before you change the law.

You could start with defense. You required the President to submit a two-year defense budget this year. Even if you want to reserve judgment on a few controversial weapons systems, you could budget and appropriate for most of the defense function for two years.

You would need to invent serious procedural impediments to re-opening the two-year appropriations bill, once it was adopted. Biennial budgeting can have beneficial results only if you solve this problem. Toward that objective, you might examine the mechanism contained in last year's budget governing consideration of the funds which were "fenced" in the resolution.

Waiving Points of Order

We believe that rules waiving points of order under the Budget Act should require a two-thirds vote. This includes points of order under section 302(b) for appropriations bills in excess of their 302(b) allocations, points of order under section 311 for legislation which breaches the spending ceiling and/or revenue floor of a budget resolution, and points of order under section 303 for the consideration of appropriations (up to May 15 of each year) and entitlement legislation in advance of a conference report on the budget.

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The House Budget Committee

We believe the budget process would be more effective if the House Budget Committee and the House Budget Committee Chairman were appointed in the same fashion as other standing committees and chairmen -- on a permanent basis.

Budgeting is a leadership function, and it may be appointments to the Budget Committee should be Leadership appointments.

The House and the budget process sacrifice a great deal under the current system. Many Members gain knowledge of the process, but your Budget Committee cannot make maximum use of that knowledge.

House Budget Committee Members' first allegiance, under the current system, always will be to their Permanent Committees. When the system was adopted, this structure was necessary to blunt the opposition of many powerful senior members of both parties. I doubt that this opposition now exists to the degree it formerly did.

You may now be able to correct that mistake. We are well aware many members dislike the budget process. But if it did not exist you would have to re-invent it. The nation needs a viable, effective budget process.

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A Process for Budget Process Reform

Dick Bolling reminds us, when we designed the Congressional budget process we began with a bicameral, bipartisan task force. Any attempt to reform the process should begin once again in such a forum.

The budget process is unique. It belongs to the whole Congress. If the House and Senate begin budget process reform on separate tracks, you likely will devise different systems. If the House and Senate wind up with different systems, Congress will have no effective budget process.

A bicameral group should decide first the outlines of any revised budget process, then each House should write whatever rules are necessary to implement the agreed upon process in its chamber.

Conclusion

In conclusion let me say: I may have gone beyond your agenda today in these remarks. We believe, however, that the budget process is at the heart of the legislative process.

Our Constitution is unique. It vests exclusively in Congress, and specifically in the House, responsibility for and authority over federal fiscal policy. Congress cannot expect to carry out its responsibilities, you cannot expect to regain effective control over fiscal policy, unless you have an effective system within which to make fiscal policy decisions.

There are no decisions you will make about Congress' own institutional arrangements that are more important than those you make about your own budget processes. We thank you for this opportunity to share our Committees' views with you. We will do anything we can to assist you in this important undertaking. Please call on us. Thank you.

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ATTACHMENT III

The Need for a Better Budget Process

Alice M. Rivlin

THE TIME has come to simplify the federal budget process. Hardly anyone likes the complicated and arcane procedure the U.S. government uses to arrive at a budget. The process consumes enormous amounts of executive branch and congressional time and even then is rarely completed. Deadlines are missed, and government agencies frequently run on "continuing resolutions" rather than regular appropriations. Occasionally a president makes a show of closing down the government for a few hours because agreement has not been reached on further funding.

Frustrated with continuing budget deficits and their inability to reduce them, Congress and the president agreed in the fall of 1985 on the Balanced Budget and Emergency Deficit Control Act, better known as the Gramm-Rudman-Hollings law. The law, which set up a mechanism to balance the budget in five years, was enacted in desperation to break the deadlock between Congress and the president and reduce the deficit, but not even its staunchest defenders regard it as a desirable process for making a budget. Whether or not this desperate gamble will work to cut the deficit, the question remains: what can be done to improve the budget process?

A drastic simplification is in order. Most spending decisions should be made for two or more years at a time, and possibly the whole budget should be shifted to a biennial basis. Congressional committees should be restructured to combine the authorization and appropriation functions. The budget itself should be simplified and the number of line items greatly reduced, actions that would help shift congressional attention toward major policy issues and away from detailed micro-management. As for the Gramm-Rudman-Hollings law, I share the hope that it will hasten agreement on deficit reduction, but regard it as a bad budget process. Constraining the budget deficit to a particular number—whether by law or constitutional amendment—risks destabilizing the economy.

Why Making a Federal Budget Is So Hard

Making the budget process simpler and more comprehensible, however, would not make the decisions easier. Budget-making is inherently difficult for any organization, whether it be a family, a business, a university, or a government. There are never enough resources to carry out all desired activities. Choices have to be made, and these choices often bring to the surface deeply divergent views about the organization's purpose, how that purpose should be carried out, and who should bear the burdens or reap the benefits. Nevertheless, most organizations do manage to make budgets and live with them. Why is the U.S. government experiencing such agonizing difficulty?

Four conditions can make it especially difficult for an organization to agree on

Alice M. Rivlin is the director of the Economic Studies program at Brookings. From 1975 to 1983, she served as the first director of the Congressional Budget Office. Together with four Brookings colleagues—Henry J. Aaron, Henry Golper, Joseph A. Peckman, George L. Perry, and Charles L. Schultze—she is co-author of *Economic Choices 1987*. This article is adapted from a chapter of that book.

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a budget. First, it is harder to make a budget when there are lots of choices regarding both income and spending. Poor families have to eat and pay the rent; poor governments have to defend the borders and deliver the mail. Neither has many choices. Life is easier for families and governments with more earnings and sources of revenue, but budget choices get more complicated.

Second, budget-making is more common when the organization has access to credit. Without credit, families would be far less adequately housed and equipped, businesses would find it hard to function, states and localities would forgo building needed facilities. If it were unable to borrow, the federal government would be forced to raise taxes or cut spending during recessions, making swings in the economy much wider. But governments, like families and businesses, can over-borrow, and the question of how much to borrow or pay back makes budgeting more complicated and contentious.

Third, variations in prices, equipment, incomes, and responsibilities make it difficult for an organization to estimate future costs and revenues and reach decisions about them. Finally, and most important, budget-making is hard when the organization has multiple decision-makers with different convictions about what the organization ought to do and how it ought to do it. The situation requires a budget process—a procedure for arriving at choices, debating what should be done, and making decisions.

The U.S. government is subject to all of these budget-complicating conditions in extreme form. It has the taxing capacity of a wealthy country and faces a high level of world and domestic responsibilities. It has apparently unlimited access to credit and has experienced the uncertainties about costs and revenues associated with wide swings in prices and economic activity and with unexpected world events. But most important is the decision-making complexity inherent in the constitutional separation of powers between Congress and the president. The president can propose changes in budgetary policies, but the ultimate power to levy taxes and authorize spending of public funds is lodged in Congress, subject only to presidential veto. This divided rule works well when the president and Congress are in broad agreement or are willing to compromise their differences. It leads to deadlock and frustration when congressional and presidential views differ and one or both are unwilling to strike a bargain. Recent deficits have reflected the collision between the president's unwillingness to increase taxes or reduce defense growth and Congress's refusal to cut domestic spending by the amounts or in the ways proposed by the president.

One can imagine a contentious family with differing views on how to reduce its budget deficit arriving at a procedure like Gramm-Rudman-Hollings. First, some members might argue that the deficit is temporary and the family will "grow out of it"; others that the deficit does not matter. Gradually all realize that they are facing a permanent and potentially damaging gap between expected spending and expected revenues and that debt and interest payments are rising rapidly. Members of the family propose different plans for adjusting spending and revenues and are unwilling to compromise. Finally, someone suggests that all spending be cut by a fixed percentage until balance is restored. But some expenditures—the mortgage, car payments—cannot feasibly be reduced, so these are exempted.

"Surprisingly, despite all the talk about the budget and the budget process, no budget for the U.S. government is ever actually enacted as such."

The percentage by which the remaining items must be cut to meet the target then rises. Everyone recognizes that this is an undesirable way to make budget decisions, but they are so desperate to reduce the deficit that they agree that the formula cuts will automatically come into effect on a specific date if they cannot settle on a more satisfactory way of reducing the deficit in the interim. This is how the U.S. "family" adopted Gramm-Rudman-Hollings.

Evolution of the Process

Surprisingly, despite all the talk about the budget and the budget process, no budget for the U.S. government is ever actually enacted as such. Government spending and revenue in any one year result from the application of a large number of separate laws enacted at different times that specify how the government can raise and spend money. The elaborate set of documents labeled *The Budget of the United States Government*, which the president issues with such fanfare each year, is really a set of proposals, detailed estimates of what will be spent and collected in the next year if the president's recommendations for spending and taxing laws are accepted by Congress and the economy behaves as the administration assumes (or hopes) it will.

Because of the separation of powers, the history of budget-making in the U.S. government is two separate histories: that of executive branch efforts to evolve a procedure for crafting the president's budget proposals and that of congressional efforts to make spending and taxing decisions in a more orderly way. Gramm-Rudman-Hollings is unique because it tries for the first time to deal with the efforts simultaneously and create a procedure for forcing the president and Congress to attain an agreed budget deficit target together. It is not yet clear whether this objective can be achieved in a way that does not violate the constitutional separation of powers.

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ny suffered an unexpected recession in the middle of the multiyear budget period. Congress might well want to consider changing tax rates or accelerating some spending programs. But this could be done — as it is now — without reconsidering the whole budget.

Numerous bills proposing multiyear budgets have been introduced — most calling for biennial budgeting, which is used by many state governments — and some hearings have been held. Some biennial budget bills envision Congress spending the first year of each session on program oversight and other matters and handling the two-year budget in the second year of the session. Under this arrangement a newly elected president who wanted to alter his predecessor's budget either could use the first year of his term to build support and understanding for the changes or could move ahead more rapidly to amend the existing budget. Other bills would have each Congress make a two-year budget in its first session and use the second to consider other legislation.

Even if the whole budget were not moved to a multiyear basis, Congress could get many of the same advantages by shifting to multiyear authorization or appropriation or both in major areas of the budget. Defense seems an especially good area for such a change. Indeed, recently enacted legislation requires the Department of Defense to submit a two-year budget beginning with fiscal 1988 and 1989.

While legislators sometimes argue that they would have less control over federal activities if budgeting were done less often, they actually would be better able to make significant changes. Major shifts in direction, such as bringing down the deficit or modernizing the armed forces, cannot be accomplished in a single year. A longer budgeting period would give greater scope for such major shifts to be designed and carried out. Indeed, in the last several years Congress has of necessity moved to a multiyear budget resolution with accompanying reconciliation measures. The dramatic changes of 1981 involved a three-year budget resolution as well as a three-year tax bill. Subsequent efforts to bring down the deficit necessarily involved more than one year, so three-year budget resolutions have become standard. Nevertheless, appropriations and many authorizations are still done one year at a time. It is time to move the whole process to a two-year cycle.

Consolidating the Authorizing and Appropriating Functions

In principle the legislative or authorizing committees write the basic legislation that governs how federal programs function, and the appropriations committees budget specific sums to carry them out. In practice the distinction between the two has often blurred in recent years, perhaps because of the intensity of interest in the budget and the small number of new programs being considered. In working out the defense budget, for example, the authorizing committees and appropriations subcommittees often appear to be doing exactly the same thing — subjecting the budget to line-by-line scrutiny with special attention to procuring weapons systems. Such duplication wastes the time and energy of Congress and executive branch alike.

On the other hand, spending for entitlements, now two-fifths of the budget, is outside the appropriations process. The bulk of entitlement spending is handled by the tax

*"A further step,
one with considerable appeal,
would be to hold
all spending and tax bills for
final vote at the same time."*

committees, sometimes creating logjams for these over-worked committees.

Restructuring the committees would improve the budget process. Ideally each major area of federal activity — defense, income security, national resources, and so forth — should have a program committee responsible both for drafting basic legislation and for reviewing budgets in its area. Each would handle both entitlement programs and discretionary appropriations. Revenue committees would handle only revenue, not spending, programs. The budget committees would be charged with putting together an overall budget strategy that would include both revenue and spending. They would also consider relative priorities among programs and recommend appropriate fiscal policy.

A further step, one with considerable appeal, would be to hold all spending and tax bills for final vote at the same time. Indeed, they could be put into a single bill. Congress would then be voting on a budget for the whole government and sending it to the president in one package. This type of budget action is standard in many governments, but the U.S. government has never had a budget voted this way.

Reducing Micromanagement

Under present procedures a single omnibus appropriations bill would be an appallingly long document. This length is symptomatic of a basic problem of the budget process: the tendency of Congress to budget in too much detail. The current budget is divided into thousands of budget accounts and subaccounts. The executive branch is given very detailed line item budgets with little authority to shift money from one item to another as conditions change. This detail makes the budget process an arcane business and

focuses congressional time and energy on minutiae rather than on overriding issues of policy.

Drastically cutting the number of line items in the budget would be desirable but would make a real difference only if accompanied by a genuine change in the way Congress perceives its own role. Congress would have to begin functioning more like a board of directors making major policy decisions for the country and less like a group of 535 managers specifying detailed operations for the executive branch.

None of the changes suggested here would require amending the Constitution. Each could be accomplished by legislation or changes in House and Senate rules and customary practice. All the recommendations, however, would meet with strong opposition in Congress (and to some extent in the executive branch) because each threatens the existing power structure. Multiyear budgeting would deprive Congress of the annual chance to impose its will in appropriations and other budget legislation. Consolidating the authorizing and appropriating processes would reduce the number of committee and subcommittee chairmanships.

Budgeting in less detail is perhaps the most threatening of all, because Congress has a long tradition of making itself felt and protecting constituent interests through tinkering with line items. Nevertheless, Congress is highly frustrated with the current system, which imposes an exhausting workload but yields little satisfaction of accomplishment. Once the deficit crisis is at least partially resolved, but before memories of this stressful period recede, the chance for substantial reform of the budget process seems high.

Other Possible Reforms

President Reagan favors two major changes in budget procedures that he believes would work to hold down federal spending and deficits: a constitutional amendment to require a balanced budget and a line item presidential veto. Both proposals are troublesome.

Requiring balance in the budget regardless of the state of the economy could force the federal government to adopt an inappropriate fiscal policy. Drafts of constitutional amendments usually have escape clauses, but it is difficult to foresee the variety of special circumstances that could affect future fiscal policy. Such amendments usually empower a super majority (two-thirds or three-fifths of Congress) to override a requirement to balance the budget. Such a clause, however, might create an incentive for legislators with favorite spending projects to trade the inclusion of these projects for their agreement to join the super majority. Spending and deficits might actually end up larger than without the amendment. To the extent that an amendment to balance the budget holds down federal spending, however, it may lead the government to substitute additional regulation for spending and to achieve goals by requiring businesses or state and local governments to make certain kinds of expenditures. Such amendments also provide a strong incentive to create off-budget agencies or engage in "creative" accounting. All in all, the risk of trying to handle a complex issue like fiscal policy by amendment to the Constitution, whose greatest virtue is its brevity and flexibility, seems far greater than the benefits.

The proposed line item veto also presents problems. While the president may use his veto power only to reject a

whole bill, many state governors have the power to veto individual line items without rejecting the whole bill. Numerous presidents have asked for a line item veto, a power that they hoped would forestall the congressional tendency to insert spending items with which the president disagrees into bills he needs and does not want to veto.

The line item veto would enhance the power of the president and diminish that of Congress, but it is easy to exaggerate its impact. The president needs congressional support for his programs and is unlikely to risk antagonizing many members, especially chairmen of important committees and subcommittees. Moreover, the latter could doubtless find ingenious alternative ways of protecting favorite line items, such as military bases or other federal installations, from presidential veto. A committee could hide a threatened line item in a larger total, for example, but add language stating that none of the funds are to be used to close the specified installation. Moreover, while a conservative president might use a line item veto to cut pork barrel spending projects, a big-spending president might use the threat of a line item veto to garner votes for spending he favored.

In any case it is not realistic to think that the line item veto would reduce the current deficits appreciably. President Reagan is unlikely to use a line item veto to reduce defense spending. Interest payments cannot be vetoed, and entitlement programs generally do not come to the president in a form in which such a veto would be possible. The president might use the line item veto to kill a few domestic spending items of largely local interest, but the spending impact of such actions would be small.

Conclusion

Simplifying the budget process along the lines discussed would make the process more understandable and less exhausting and would probably lead to more thoughtful decisions. It is important, however, not to claim too much for procedural change. A well-designed budget process can, at best, do three things. It can reduce but not eliminate uncertainty by making sure that participants have the best available projections and analyses of budget options in intelligible form. It can also put the sequence of decisions in a logical order so that participants have a chance to make the most important decisions, not just the subsidiary ones. The lack of order was the weakness in the congressional budget process corrected by the reforms of 1974. Finally, a well-designed budget process can save time for decision-makers so that budget affairs do not overwhelm other activities of government. The current process fails miserably on this last criterion.

No set of procedures, however, can force participants to make choices that they do not want to make or do not regard as necessary. Reforms to the process cannot substitute for political will or for the exercise of leadership in working out compromises among warring parties. As long as the government sticks with a system under which power is divided between the president and Congress — and separation of powers should be maintained — the priorities of the president and Congress will occasionally conflict. Changes in the budget process are unlikely to cure this situation. Resolution of the conflict will still require statesmanship and the willingness of both sides to compromise.

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The President's Budget

The U.S. government had no budget decision process at all until after World War I. Throughout the nineteenth and early twentieth centuries, the central government had few budget responsibilities, and government agencies took their requests for funds directly to Congress.

The Budget and Accounting Act of 1921 represented a major departure from these practices: it was the first in a series of institutional changes designed to make sure the president controlled requests for funds and proposed a budget that reflected the views and priorities of his administration. The act created a new staff, now called the Office of Management and Budget, charged with examining the requests of agencies and providing the president with the information on which to base budget proposals.

Subsequently, the Employment Act of 1946 charged the newly created Council of Economic Advisers with responsibilities for forecasting economic developments, assisting the president in formulating fiscal policy, and making an annual economic report to Congress. In the 1950s and 1970s the executive branch attempted to improve the systematic evaluation of government programs, to look further into the future at needs for government action, to estimate the costs, benefits, and distributional effects of alternative spending or taxing programs, and to put the budget decision-making process on a firm schedule.

Thus by the early 1970s the executive branch of the government had institutionalized budget-making. The president was well equipped to translate his political predictions into budget proposals. But the result of all this executive activity was just a set of proposals. Congress was responsible for making the ultimate budget decisions.

The Congressional Process

Unlike the executive branch, by the 1970s Congress had evolved no comparably centralized institutions. Before 1974 no committee had legislative responsibility for budget policy as a whole. Many spending decisions were made in two stages. First, legislative committees worked on bills authorizing spending for particular programs. Even after such bills were passed by both houses and signed by the president, no money could be spent until separate appropriations bills made their way through another set of committees in both houses and were approved and signed into law. More than a dozen major appropriations bills were voted on at different times of the year. Relative priorities, such as defense as opposed to education or health, were never explicitly considered.

Spending for social insurance and other entitlement programs, which was growing rapidly in the 1950s and 1970s, remained outside the normal appropriations process. Amounts spent on these programs were determined automatically once the characteristics of beneficiaries and the level of their benefits were defined by legislation.

Revenue bills came out of different committees and were voted on separately from spending measures. Because the spending and taxing sides were never brought together, Congress never voted on the question whether revenues and expenditures were in appropriate relationship to each other. Congressional budget policy was the accidental result of spending and revenue decisions influenced by different committees and made at different times.

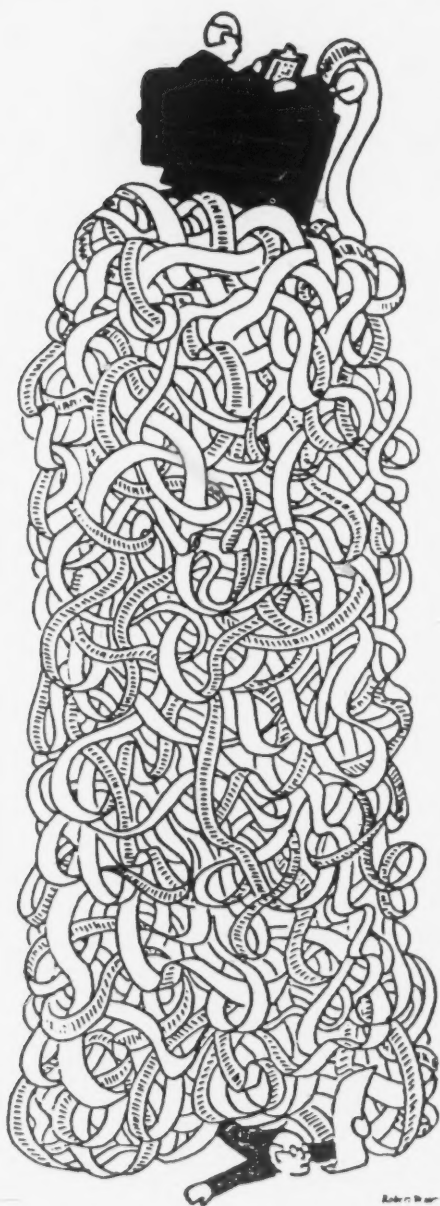
Spurred by feelings of frustration and a growing sense of crisis, President Nixon, whose priorities differed from their own, members of Congress finally took a long overdue step and passed the Congressional Budget Act of 1974. The act created budget committees in each house charged with formulating an overall budget policy that, when passed by Congress in the form of a budget resolution, would serve as a controlling framework within which individual taxing and spending measures could be lined. It also created the Congressional Budget Office to give Congress an objective, nonpartisan source of budget analysis and information.

The budget act provided for an elaborate three-stage process spread over a nine-month period between January, when the president's budget proposal is made, and October 1, when the new fiscal year begins. In the first stage the budget committees would produce a first concurrent resolution on the budget that would specify the aggregate level of federal spending for the next year, break down that spending by major categories (but not by detailed line items), and indicate revenues to be available and the resulting deficit or surplus.

After this resolution was agreed upon, specific appropriations and tax bills would be passed in line with the aggregate numbers specified in the resolution. The figures in the first resolution, however, were regarded as targets and were not absolutely binding. In the final stage Congress would reconsider whether the targets were still appropriate and, if necessary, reconcile specific bills with the desired aggregates. A second concurrent resolution on the budget — this time a binding one — would then be passed.

The 1974 law gave Congress a much needed mechanism for making overall budget decisions. Unfortunately, it also made an already complex and lengthy decision process still more complicated and time-consuming. The new procedure retained all the existing authorizing, appropriating and tax writing committees and added yet another layer.

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law] also made an already
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the budget committees. The resulting schedule of arduous and difficult decisions to be made in sequence each year was impossibly demanding, even if reasonable agreement existed on overall budget policy.

For example, it soon became apparent that two budget resolutions were too many. The compromises on budget priorities needed to pass a first budget resolution were difficult to achieve and often occurred later than the May 15 deadline. Once an agreement was reached, no one wanted to reopen the arguments. Hence the second resolution quickly became a formality; it was officially folded into the first.

The new decision process established by the Congressional Budget Act of 1974 accomplished its major purpose. It gave Congress a forum for deciding fiscal policy. The new procedures were expected to strengthen congressional power at the expense of the president's. However, in 1981 President Reagan, aided by his aggressive budget director David A. Stockman, used the centralized features of the congressional budget process effectively to obtain congressional approval of drastic changes in the federal budget. The major elements of the Reagan program—tax cuts, increases in defense spending, and reductions in domestic spending—were embodied in a three-year budget resolution and passed by Congress as a package.

Reconciliation, the process originally associated with the second budget resolution, was used to bring enactment programs and other ongoing spending legislation into conformity with the reduced domestic spending totals in the first (and only) budget resolution. These numerous, complex, and sometimes far-reaching changes in existing laws were also voted as a single package.

The events of 1981 showed that a president with strong views on budget priorities and a recent election mandate could use the congressional budget process to obtain rapid ratification of dramatic changes in the budget as a whole. The fragmented decision process that existed before the 1974 reforms would have made these instant, simultaneous changes in many parts of the budget much less feasible. President Reagan's use of the reconciliation process for wholesale alteration of detailed spending legislation, however, left many congressional committees, especially in the Democratic House of Representatives, bruised and determined to reassert their traditional powers.

The budget decisions made in 1981 resulted in enormous deficits in subsequent years. The tax cuts reduced federal revenues as a percent of gross national product while spending continued to increase. The future deficits were not anticipated in 1981, in part because the budget resolution assumed unspecified future cuts in domestic spending that never materialized. More important, however, the budget resolution was based on optimistic economic assumptions that soon proved totally unrealistic. The recession precipitated by high interest rates in 1981 caused a rapid surge in deficits. Financing an escalating debt at high interest rates led to unprecedented increases in federal spending for interest payments. As a result, increases in spending for defense and interest substantially exceeded cuts in domestic spending, leaving a growing deficit even as the economy recovered.

Beginning in 1982, rapidly escalating deficits subjected the entire federal budget process to extreme stress. Under this stress two weaknesses of the decision process stood out:

clearly, the fiscal problem, built into the consensus on resolving any difficult problem when the president and Congress disagree, and the layering of the process that made it unwieldy and time-consuming in normal times and close to nonfunctional under stress.

Difficulties of Divided Power

The debate over each successive budget since 1981 has been dominated by clashes of views over the deficit. Between 1982 and 1984 President Reagan vacillated on the seriousness of the deficit: sometimes alleging that it would disappear as the economy grew and sometimes deploring it and calling for reduced domestic spending. Presidential budget proposals reflected a consistent budget strategy that continued the defense buildup, rejected both tax increases and cuts in social security, and proposed substantial reductions in many domestic activities. Congressional leaders generally made stronger statements about the necessity of getting the annual deficits down, but differed with the president and with each other on how to do it. Actual budget actions reflected painfully engineered compromises that generally pared back the president's defense increases, accepted some but by no means all of the proposed domestic cuts, and raised revenues somewhat, most notably in 1982 when aspects of the generous tax cuts of the previous year were rescinded. The result was to reduce anticipated further increases in the deficits but to leave them still at unprecedented levels even though the economy began recovering rapidly in 1983.

By 1985 both the administration and Congress had come to realize that the deficits would not disappear with economic growth and were a threat to the long-run health of the economy. But views on what to do about them had not converged. The battle over the fiscal 1986 budget was long and bitter. It resulted in congressional rejection of further defense increases in that year and of most of the deep domestic spending cuts proposed by the president. The president first accepted and then pulled away from a Senate-passed proposal to suspend the social security cost-of-living adjustment and similarly rejected all efforts to reduce the deficit by increasing revenues. Although final budget actions made inroads on future deficits, the conflict left all parties feeling frustrated, discouraged, and helpless.

In this atmosphere the Gramm-Rudman-Hollings proposal was offered in the fall of 1985 as an amendment to a necessary increase in the debt ceiling. Unexpectedly, it gained wide support. Although members of his administration expressed reservations about the approach, especially about the possible impact on defense spending, the president endorsed the proposal and it passed quickly.

The law sets annual targets that reduce the budget deficit to zero in fiscal 1991. If in any year agreement cannot be reached on the specific measures needed to achieve those targets, the law provides a mechanical formula that cuts defense and civilian spending in approximately equal amounts sufficient to meet the goal.

The impact of the new law was felt immediately. Application of the law's mechanical formula on a limited basis in fiscal 1986 cut \$11.7 billion from spending in that year and reduced the spending base by substantially more than that for future years. Reaching the targets by applying the formula in 1987 and beyond, however, would seriously im-

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pair the effectiveness of both civilian and defense programs. It is hard to believe Congress and the president will allow this to occur. The hope is that the desire to avoid this outcome will bring about agreement on a more sensible way of reaching the targets.

The current situation is complicated, however, by the possibility that the Supreme Court may uphold a circuit court ruling that the automatic formula is unconstitutional because it involves having an officer of Congress (the comptroller general) certify what cuts are to be made by the president. The lower court held this to be a violation of the constitutional separation of powers. If the Supreme Court upholds the lower court, Congress can still use a procedure or the law that involves voting to withhold the funds specified by the formula. It might be reluctant to do this, however, and if it did, the president could veto.

Even if Gramm-Rudman-Hollings forces agreement on a deficit reduction plan, it is an undesirable budget process. First, the procedure, which requires cutting every unencumbered line item in the budget by a fixed percentage, allows no reconsideration of priorities and could lead to absurd and unintended results. Second, the adoption of a fixed dollar target for the deficit can destabilize fiscal policy.

Finally, Gramm-Rudman-Hollings does nothing to reduce the layering and complexity of the current budget process. The law does strengthen enforcement of the budget resolution, which should improve congressional self-discipline, but it also adds to congressional workloads and accelerates deadlines that were already proving impossible to meet. For example, the law requires Congress to pass the budget resolution by April 15, although the current deadline of May 15 has not been met in some years. Deadlines are missed in large part because the process itself is overly complicated. Congress will not solve this problem merely by exhorting itself to try harder to finish on time.

Ways to Simplify the Process

Even before it was subjected to the stress of dealing with large deficits and divergent views among House, Senate, and president, the budget process was showing signs of breaking down of its own weight. Participants complained about the length of time spent on each budget—at least six months for preparation of the president's proposal and at least nine months for congressional decisions. Deadlines were missed regularly, and continuing resolutions became more and more frequent because agreement often could not be reached on regular appropriations. Participants also complained about the multiplicity of congressional committees with overlapping jurisdictions. Testifying on the same issues before several committees on both sides of the Hill consumed the time of executive branch officials and members of Congress alike.

Moreover, the frequency with which the same issues came up for consideration meant that many decisions were never final. Crucial votes on major weapons systems, such as the MX missile, were occurring in each house three or more times in a single year in the context of authorization, appropriation, and budget action. Congress seemed more and more immersed in the details of federal programs and less and less concerned with the overall directions of federal policy. A growing number of members and observers of Congress have come to believe that drastic change is

needed to improve the effectiveness of the congressional budget process. But the deficit crisis itself has delayed serious consideration of procedural change.

Three types of reform would make effective decision making more feasible: making decisions less often by moving to a multiyear budget; reducing the number of committees by consolidating the authorizing and appropriating processes; and simplifying the budget itself by reducing the number of accounts and line items.

Multiyear Budgeting

An obvious way to reduce the time spent on the budget process would be to go through the process less often, perhaps every other year. Less frequent budgeting has many clear benefits. The managers of federal programs and the recipients of federal grants could plan programs more effectively if they could assume funding for a longer period. They could spend more time managing and less time preparing and defending budgets and adjusting to funding changes. And Congress, relieved of annual budget battles, could devote more attention to long-run issues and more careful oversight of federal programs.

Spending levels for some programs are of course affected by unpredictable cataclysmic events, such as the outbreak of war. But such events have to be dealt with on an emergency basis even with an annual budget process. It is hard to imagine that most federal programs benefit more from hasty annual review than from more thorough, better prepared evaluation at longer intervals.

It is true that budgeting depends on economic assumptions about the future and that longer-run forecasts are more uncertain. But only a few programs are greatly affected by the state of the economy, and many of these are entitlement programs that adjust automatically. If the econ-

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SYMPOSIUM
on
BUDGET BALANCE:
DO DEFICITS MATTER?

New York City

January 9-11, 1986

Sponsored by

American Association of Retired Persons
American Stock Exchange
Avon Corporation
The Business Roundtable
Committee for a Responsible Federal Budget
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A FACTUAL BASIS FOR FISCAL MYTHOLOGY:
THE NORM OF BUDGET BALANCE IS IMPORTANT

by

Dr. Susan J. Irving

Introduction

Over the past several years the a near-obsession with the deficit has combined with an apparent inability to break the deficit path. A comparison of record high peacetime deficits with the experience of the first 175 years of American history led inevitably to the questions: "Has the United States abjured the norm of budget balance? If so, what will take its place? and If not, if the norm of budget balance remains important, how do we get from here to there?"

This group of questions served as the organizing theme for a symposium on budget balance held at the Plaza Hotel in New York City in January 1986. That symposium was cosponsored by the Committee for a Responsible Federal Budget, The American Association of Retired Persons, The American Stock Exchange, Avon Corporation, The Business Roundtable, General Foods Corporation, GTE Corporation, and the Kerr Foundation.

The overwhelming consensus at that meeting was: The norm of budget balance is important. Participants did not agree on specific spending cuts and/or tax increases to balance the budget. They differed as to whether it is necessary to balance the budget every year, or over the business cycle, or on a "high employment" basis. But everyone agreed the norm of budget balance -- Representative Newt Gingrich calls it the mythology of budget balance -- is the only effective constraint on fiscal policy decisions in our system of government.

Some symposium participants argued we need a balanced budget constitutional amendment. Others oppose writing fiscal policy into the constitution. Most agreed with Senator Rudman that the new Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings) is, "a bad idea whose time has come." Many, however, think that law is a dangerous example of politicians substituting process for substance in an attempt to avoid responsibility for difficult decisions

Almost everyone at the meeting agreed: Even if the sequester process in Gramm-Rudman-Hollings is constitutional, Congress and the President must agree on an alternative, more balanced approach to move the budget back toward balance. No one at the symposium thought we could or should balance the budget through a series of across-the-board cuts over the next five years.

This volume contains papers presented at the January symposium, and edited transcripts of the discussion. It is divided into sections so that interested readers may dip in and out by topic. It provides a brief historical background, an overview of the themes raised and discussed at the conference, and a session-by-session summary or "browser's guide" throughout

The meeting was one-and-one-half days of lively discussion. It is our hope that this book will give the reader a sense of the spirit as well as the substance of the meeting. It was very exciting. It did not solve the deficit dilemma, but the fact that so many people from such different backgrounds found so much common ground for constructive dialogue bodes well for our ability as a nation to come to grips with this very important issue.

Background: The Norm of Balance in American History

Today the federal deficit seems a familiar companion. Most of those involved in budget debates can remember only one or two (if any) balanced budgets. In political discourse we refer to "years of deficit spending" and to "\$200 billion deficits as far as the eye can see." Over the last several years it has often seemed that Congress does nothing but wrangle over the budget -- and with little success.

Popular wisdom has it that the American political system always or usually has produced budget deficits. As many of the symposium participants knew, the truth is to the contrary. And examination of U.S. fiscal history shows strong adherence to the norm of budget balance.¹

The nation started with a debt from the Revolutionary War. Early Congresses, however, set out to reduce that debt, and it had been cut nearly in half when the War of 1812 broke out. Over the next 150 years any graph of U.S. budget policy would show a pattern around episodes of war. The debt ballooned in wartime (War of 1812; Mexican War; Civil War; Spanish-American War), but postwar Congresses exhibited an incredible commitment to fiscal restraint. The Civil War nearly tripled the federal debt, but "in the 31 years between 1867 and 1897 there were 27 years of budget surpluses."²

Even in the 1896-1916 period with wars, recessions, and a general expansion of the federal government's activity, the U.S. government ran nine years of surplus to eleven of deficit. The federal debt in 1916 was nearly identical to that of 1896! Budgets may not have been balanced annually, but the norm of balance still held -- just over a longer time frame.

The cost of World War I moved the public debt from \$1.23 billion in 1916 to \$25.5 billion in 1919. By 1930 it had been cut to \$16 billion. The depression and World War II combined to create a public debt in 1946 equal to 120% of GNP! Again the postwar response was restraint. By 1961 -- despite several recessionary periods -- the debt was actually lower than in 1946.³

In sum, the history of the U.S. government to the 1960s is one of fiscal responsibility. Increases in the national debt occurred in times of war. In peacetime, Congress retrenched -- sometimes rearranging institutional structures to assist in that retrenchment. As Norman Ornstein has observed:

Our national debt to this point was built very largely on periods of war. Without the deficits caused by the War of 1812, the Mexican War, the Civil War, and the Spanish-American War, the federal government would have had a \$1.6 billion surplus at the beginning of the twentieth century. Without the deficits caused by the two world wars, it would have had a gross debt of under \$30 billion--or less than 5% of GNP--in 1961.⁴

The 25 years since 1960 are characterized by a very different trend. Although the debt to GNP ratio continued to decline until 1980, the U.S. Government ran deficits almost every year. Debates over tax cuts and spending decisions reflected some concern with the deficit. (Between 1960 and 1981 the deficit averaged less than 2% of GNP and exceeded 3% only during the 1973-75 recession.) In 1974 Congress decided to reform the budget process.

In the aftermath of Vietnam War spending, tired of constant conflict with President Nixon over impoundment, concerned that Congress had no source of budget data other than the administrative agencies, frustrated that Congress had no mechanism to articulate an alternative to the President's budget and, yes, concerned that the budget (or spending or deficits) were "out of control," Congress passed and the President signed The Congressional Budget and Impoundment Control Act of 1974.⁵

That Act is only the most recent example of Congress' responding to growing budgets and perceived budget problems by changing the budget process. Exponential growth of government during the Civil War led to the separation of spending and taxing authority in Congress, and the creation of appropriations committees. In the aftermath of World War I, Congress decided the nation needed a better budget process and more effective institutions to cope with larger more sophisticated government. They created the office of Comptroller General and the Bureau of the Budget, and they required the President to submit a consolidated budget once a year. And Congress adopted a new budget process again after World War II.

In recent years dissatisfaction with the outcome of the annual budget debate -- and with Congress in general -- has been expressed in denunciations of the Congressional budget process. Too easily forgotten are the gains from the 1974 Act: establishment of the Congressional Budget Office and thus of an independent source of data and expertise for the Congress; an explicit recognition of the aggregate results of independent spending and tax decisions; some restraint imposed on individual committees by the Congress as a whole.

The 1974 Act was important, but it could not make up for a change in the political and fiscal climate. Between 1981 and 1986 the public debt has doubled in absolute terms. As a share of GNP it has moved from 27-1/2 percent to 40 percent. This has happened despite a nation at peace and a recovery now entering its fourth year. We are operating outside the range of historical experience.

Neither the symposium nor this paper discusses how we got from 1960 to 1980, nor from 1980 to 1986. For an institutional analysis and commentary on the Congress readers are referred elsewhere;⁶ for blow-by-blow descriptions, readers are referred to the press coverage at the time.

The symposium started with the present. It looked back for comparison and to ask if our norms had changed. Participants have different perspectives on causes of the current deficit problem. All agreed that the current situation is unacceptable.

Themes

Any budget debate is, explicitly or implicitly, a debate about the role of government and about priorities: In what activities should government engage? How much should be spent on each activity? How should government spending be financed? Both the scope (size) and relative priorities of government are decided in the federal budget. Budget decisions (meaning tax and spending decisions) determine the distribution of benefits and pain.

A debate about the role of government and about priorities is easiest when the task is to allocate pleasure (spending increases or tax cuts). It is somewhat more difficult when existing resources must be reallocated. It is most difficult when the task at hand is the allocation of pain.

Reducing the deficit is not an arithmetically difficult problem. It is a political problem -- not so much partisan electoral politics as politics in a broader sense. The President and each Member of Congress have their own hierarchy of priorities. Institutional prerogatives effect outcomes. In our system of government the House, the Senate and the President must reconcile their differences in order to solve the deficit problem.

Sometimes the debate, explicitly, is about the role of government. President Reagan says the Federal government should not fund Legal Aid. Congress denied the Administration's request last year for military assistance to Nicaraguan rebels. David Stockman, however, was unable to forge a broad consensus to eliminate large numbers of Federal programs and activities, despite substantial interest in reducing the size of government, i.e., total federal spending.

In part, at least, the debate is confused because real choices are too often ignored. This point may be illustrated best by reference to polling results. The American people, when asked, overwhelmingly support reducing the budget deficit. They prefer spending cuts to a tax increase. However, by margins ranging from 3:1 to 9:1 (depending on the particular item) the American people also oppose cuts in social security and other retirement programs, defense, health care, student aid, farm programs, mass transit, highways, etc. Given the composition of federal spending⁷ and given that interest payments must be made, the American people want an impossibility. The iron laws of arithmetic make it impossible to satisfy all their revealed preferences. This in turn makes it difficult for legislators who are, after all, in the business of responding to the electorate's wishes.

The revealed preferences of the American people may be inconsistent because most people's belief about where federal money goes does not match reality. They do not know that a return to budget balance requires either giving up valued programs or deciding to pay for them through increased taxes. What, however, can be said about those who do know where the money goes?

Dr. Franco Modigliani asked this question at the symposium. He asked the members of Congress why they could not educate their constituents, and he asked them why they demean the incumbent Congress. Dr. Modigliani opined that Congressmen today are at least as bright and able as those who preceded them.

There is no single answer to the question: Why isn't the debate about the real issues and the only realistic choices to move the budget back toward balance? Many symposium participants emphasize the need for Presidential leadership. And they make another important point: Pollsters and politicians tend to talk of cutting the deficit in terms of alternatives, e.g., "Do you support cutting defense; or cutting social security, or raising taxes, etc."

The fact is: It is arithmetically possible to balance the budget by cutting defense or social security, or by raising taxes. But you would have to virtually wipe out defense or social security to balance the budget by cutting only one or the other. And it would require a tax increase equal to nearly one-third of total federal revenues to balance the budget without cutting spending. None of these are politically realistic alternatives. And budgeting is a political process.

Pollsters don't ask: Which package of spending cuts and tax increases would you prefer? But the fact is: politically, balancing the budget probably will require cuts in every area of spending and some tax increases.

Some politicians have begun to tell their constituents about packages. For instance, Representatives Slattery and MacKay both spoke at the symposium about an amendment they sponsored last year. Their point is not that they want to cut social security or defense, or to raise taxes, but that they will support all three inside a package to move the budget back toward balance.

Almost everyone pays lip service to budget balance. But very few people advocate tax increases sufficient to pay for current spending levels. Some may suggest cutting one program to pay for increases in another, but that does not reduce total spending. And at the other end of the spectrum, those who oppose any tax increase at all seldom say which programs they would cut to achieve budget balance.

To some degree these half-debates reflect the fact that, rhetoric to the contrary, deficit reduction is not always the top priority. Almost everyone suffers to some degree from the "Yes, but" syndrome: "Yes it is important to balance the budget, but don't cut (you fill in the blank); or don't raise my taxes." Senator Russell Long describes this attitude as it applies to tax policy as follows: "Don't tax me. Don't tax thee. Tax that fellow behind the tree." The problem, of course, is that there is nobody "behind the tree."

Before they will solve the deficit problem, more of our elected politicians must begin to think and talk in terms of packages. And more of them must recognize that any deficit reduction package will contain some elements they don't like.

The budget debate goes on and on, with such unsatisfactory results, in part because each participant has his own top priority. For the President, the defense buildup and tax cuts are more important than budget balance. For many House Democrats, protecting some domestic programs and avoiding blame for any tax increase is the top priority. For many House Republicans, avoiding what they remember as the debacle of 1982, i.e., blame for cuts in social security leading to large losses at the polls, is the single most important consideration.

Only in the Senate has deficit reduction even approached top priority status. Even there, however, coalitions supporting specific packages have proven too fragile to survive attacks from the House and the Administration who -- albeit for very different reasons -- have ended up on the same side of the budget debate more often than not since 1981.

Despite the frustration shared by everyone at the symposium -- and by everyone involved in the budget debate -- there is a strong sense that the tide is shifting.

In part, symposium participants seem to believe the deficit has taken on a new reality for average Americans.

High real interest rates have taken a toll on the farm sector as well as housing. The tie between the deficit and the dollar, and between the dollar and trade deficits, is embedded in the consciousness of the export sector (including agriculture). Governors realize the federal government must put its house in order, or states never will be able to plan realistically their own spending and tax programs. Participation in this symposium is incontrovertable evidence: a variety of so-called special interest groups have concluded that an overall solution to the deficit dilemma is better -- even if it involves a great deal of pain -- than years of water torture, nickle-and-dime cuts, each painful, none solving the problem.

The unevenness of the current recovery and dangers to the financial system have renewed calls for a change in the monetary/fiscal policy mix; and there are signals that a reduction in the deficit is a necessary condition for relaxation of monetary policy -- that deficit reduction actually would lead to a decline in interest rates.

In 1985, these and other factors altered the shape if not the outcome of the deficit debate. The budget resolution Congress finally adopted should have reduced the deficit significantly. It is only fair to point out, however, it was a much less ambitious package than others proposed earlier in the year. Congress and the President could not reach agreement on actual spending and tax legislation to implement the budget resolution. In the last instance, the "Yes, but" forces won. Gramm-Rudman-Hollings is tangible evidence of the frustration suffered by all the actors in the deficit drama last year.

Gramm-Rudman-Hollings is, among other things, the first major change in the budget process since the 1974 Act. Over time, many became dissatisfied with the budget process. The budget process never ends. Congress seems to have time for nothing else. Those who expected the process to balance the budget are outraged. Those who hoped it would strengthen Congress vis-a-vis the President are disappointed.

Both of these criticisms blame the budget process for budget outcomes, they are based on some ideal in each of the critic's minds. The process has forced Congress to look at budget aggregates. Who knows what the budget would look like without the process. Even those who criticize the process for the President's perceived successes or failures are on weak ground. The President has succeeded or failed to get what he wants in the budget based on election results and constituent pressure.

No process can compel politicians to make politically impossible decisions; and no process can keep the President and Congress from responding when they sense a political imperative to do something.

This does not mean process changes are unimportant. Congress historically has changed institutional arrangements to encourage certain outcomes. The appropriations committees originally were created to control spending, and for many years they did so. The 1974 Act was, at least in part, another attempt better "to control" the budget. Although Gramm-Rudman-Hollings may be viewed as changing significantly the role of Congress, it may also be seen as a continuation of this process of reorganizing to encourage retrenchment. Gramm-Rudman-Hollings is an institutional change aimed at both Congress and the President. Its advocates say it will force arithmetically consistent choices on an Administration seeking to escape arithmetic, and on a Congress seeking to avoid unpleasant choices. The jury is still out.

Arithmetically consistent choices depend on an understanding of the composition of the federal budget. There are only so many ways to get from a \$200 billion annual deficit to balance. There is no painless solution. If, however, the American people do not know that eliminating both welfare payments and foreign aid (the only items in which support for cuts surpasses 50% according to the pollsters) will not balance the budget, they may continue to oppose any other steps. In a nation of conflicting priorities, compromise is necessary. How is compromise achieved?

Information is important. For many the press is the source of information about the government. In a democracy this link between the electorate and the elected is critical. What is the role of the press in the budget debate? Does the press have any obligations? How does one report on the budget without producing a string of numbers devoid of meaning -- or a horror story devoid of context?

Some of the most interesting discussion at the symposium centered on these questions. Media representatives played an important part in the meeting. They participated as panelsits in every session; and the final half-day of the conference was devoted entirely to the role of the media in the budget/deficit debate.

The budget debate is about what government should be and do. It is important and should be of great interest to most Americans. Budget battles, however, are not conducted as great debates about the role of government; they tend to sound like an arithmetic lesson -- lots of numbers. Numbers are a killer. Ask any press person. In addition, abstract discussions about the role of government seem very impersonal. To personalize the question by picturing individuals losing benefits may make the story more interesting, but it also may inflame the debate without informing it. Actors in the budget process have varying requests of the press: some want silence; most want explanations of the context in which decisions are being made. It is hard to make the issues real and understandable -- especially in 60 seconds on the evening news. The budget debate is a months-long process, but news is a daily event. Can the media explain without oversimplifying?

From the first session, which was ostensibly about economics, to the last about the role of the press, the overlap between economics and politics and between process and substance in the deficit debate was clear. Were there any other consistent threads in the discussion? Yes.

First, the norm -- or mythology to use Representative Gingrich's term -- of balance still exists. Sometimes this was stated explicitly. Other times its existence was just assumed. That in and of itself says something. No one argued that balance over some period of time was unimportant. Even those advocating policies that might be inconsistent with budget balance hid the inconsistency. This would have been unnecessary if the norm of balance had lost all validity or power.

There was disagreement over exactly how the norm should be interpreted. Some would balance the budget every year. Others would do so over the business cycle. Some would balance the budget on a "high employment basis." At another time this difference would seem larger, but in the context of universal agreement on the need to move from \$200 billion deficits toward zero it became a detail.

All participants acknowledge the past strength of Professor Modigliani's "basic understanding that we must not encroach on future generations," but some dispute the norm's ongoing power. Professor Modigliani is an optimist; he believes the norm will govern the actions of Congress again when today's peculiar situation has passed. Professor Buchanan is less optimistic. He argues that the mythology (or norm) of balance has been destroyed and should be reimposed by constitutional amendment. Others believe that norms cannot be created either by statute or constitutionally, that only widespread and deep acceptance by the public will bind government.

There is some disagreement over how we should move from the current situation to balance, but under the vociferous disagreement the elements of a compromise were visible. House and Senate, Republicans and Democrats, representatives of business, the states, and the elderly gingerly approached a package that can be described as follows: some restraint on entitlements (probably but not necessarily in the form of COLA restraint); a slowdown in the growth of defense spending; cutbacks in some non-means-tested domestic programs; and a tax increase. The questions left unanswered were the exact ratios, how such a package would be assembled, who would propose it, and whether the President could be brought along. The role of the new budget process was also an unknown: would the threat of sequester promote or impede compromise?

It would be a mistake to say the 140 participants reached closure on any of these questions. But a large majority, clearly, are headed in the same direction.

Footnotes

1. Information for this section comes from Historical Tables, Budget of the U.S. Government FY 1986, Office of Management and Budget, Washington, D.C. 1985 and from Norman Ornstein's article, "The Politics of the Deficit" in The Economy in Deficit, edited by Philip Cagan as part of a series Essays in Contemporary Economic Problems 1985, American Enterprise Institute, Washington, D.C. 1985.
2. Thomas Wander, "Patterns of Change in the Congressional Budget Process, 1865-1975" Congress and the Presidency Vol. 9 No.2 (Autumn 1982) p. 48.
3. In 1946 the debt stood at 46% of GNP. A booming economy continued the decline in the debt to GNP ratio until 1974 when it stood at 25% of GNP. It ticked up slightly with the 1973-75 recession and then turned down again. In 1981 the public debt stood at 27-1/2% of GNP. In 1985 it was 40%.
4. Ornstein, op. cit., p. 316.
5. For a history of this Act see The Congressional Budget Process: Review and Assessment, Committee for a Responsible Federal Budget, Washington, D.C.
6. For example, Ornstein, op. cit. or editions of National Journal or Congressional Quarterly.
7. Where does money go in the federal budget:

National Defense	28%
Entitlements and mandatories (social security, health, etc.)	46%
Interest on the debt	14%
Nondefense discretionary (everything else)	12%

CONVENOR'S PAPER

delivered by

The Honorable John J. Rhodes, Co-Chairman

on behalf of

The Committee For A Responsible Federal Budget

January 9, 1986

Introduction

For nearly two hundred years the norm of budget balance served our nation very well. Our budgets have not always been in balance, but almost everyone agreed they should be -- if not every year, then over some reasonable period of time.

The questions we will explore at this meeting are:

- ° Is the norm of budget balance important?
- ° Has the United States abjured that norm?
- ° If we have abandoned the norm of budget balance, what will take its place?
- ° If we continue to believe budget balance is important, how can we get from here to there?

It would appear that Congress and the President decided in December that the norm of budget balance is important. Their answer to the question, "How do we get from here to there?" was to adopt Gramm-Rudman-Hollings. There will, undoubtedly, be a great deal of discussion of the implications of that legislation at this symposium.

The Effect of Gramm-Rudman-Hollings on the Deficit Debate

- ° Will it change the political agenda?
- ° Will it compel the House, the Senate, and the President to compromise their differences on priorities -- put budget balance above personal, partisan, and institutional priorities?
- ° Will Congress adopt a budget resolution and reconciliation legislation for FY 1987?
- ° Will Congress and the President agree on changes in law to move the budget back toward balance?
- ° Will they permit a series of sequester orders to take effect?
- ° Or, will our political leaders repeal Gramm-Rudman-Hollings, either overtly or by exempting new spending legislation one bill at a time?

The Effect of Gramm-Rudman-Hollings on the Budget Process

- How will the amended congressional budget process in Gramm-Rudman-Hollings work?
- Will Congress be able to live with the new, accelerated time-table?
- Will the other budget process changes in Gramm-Rudman-Hollings prove effective?
- Or will the budget process continue to evolve, as it has done over the past ten years?

Background

One of the first decisions taken by United States of America was to repay the debts we had incurred to fight our Revolutionary War. From that time until the Keynesian revolution and the Second World War, it was generally accepted not only that the budget ought to be balanced, but that we should retire the national debt in peacetime.

Until the great depression, our country rarely incurred debt except to fight wars, and when our early wars were over we repaid those debts.

John Maynard Keynes truly did revolutionize economic thought and theory when he constructed a rationale for some peacetime deficits, but Keynes also believed those deficits should be offset by surpluses during economic boom times. The norm of budget balance still prevailed -- only we now had the concept of budget balance over the economic cycle.

The political problem with Keynesian economics is that elected officials tend to be half-Keynesian -- on the stimulus side. Almost all politicians want to reserve the option to spend money and cut taxes in recessions. But no one in recent memory has suggested seriously a program designed to produce surpluses during periods of economic recovery. Once again, witness the debate on Gramm-Rudman-Hollings. Much was made of the danger of spending cuts to the economy, should we suffer a recession. All this hand-wringing (based essentially on Keynesian theory) was by the same crowd that have run up deficits of almost \$200 billion per year during the current economic recovery. Lord Keynes must be rolling over in his grave.

Adoption of the Sixteenth Amendment, permitting our government to levy a progressive income tax, set the stage for a revolution in the basic concept of what the federal government should be and do. The Sixteenth Amendment was ratified in 1913, but the revolution really didn't begin until the 1930s. It gained strength during and after World War II and has only begun to lose force in recent years.

Many economists today believe President Hoover's attempts to balance the federal budget on the heels of the stock market collapse and ensuing depression in the late 1920's prolonged and exacerbated that depression. Certainly, Hoover's response to economic collapse and Roosevelt's campaign promises to alleviate suffering changed the political landscape

if not the economic thinking of the nation.

The presidency of Franklin D. Roosevelt, the Great Depression, and World War II changed radically the structure of our federal budget and the generally accepted role of federal government.

During the depression:

- ° We adopted, consciously, a policy of economic stabilization. Look at the budget.
 - On the revenue side: Our primarily income-tax-based system produces less revenues during economic downturns and more in periods of economic recovery; and
 - On the spending side: A large body of entitlement legislation produces increased outlays during recessions and lower outlay levels when the economy is growing.
- ° Almost everyone accepts today a federal role in alleviating unemployment, providing income maintenance for the indigent, and operating a universal retirement system (which provides an income floor for virtually all elderly Americans).
 - Before the depression, the activities of our federal government were limited almost exclusively to national defense, pensions for war veterans and their widows, the regulation of trade, and some infrastructure-related public works such as railroads and dams.
 - In addition to income support activities, the depression provided the impetus for widespread farm subsidies and rural electrification. With the dramatic expansion of our basic concept of what federal government ought to be and do, the ground was prepared for more expansion in the 1960s and 1970s into education, health, feeding programs, and many more activities identified with the Great Society.

World War II ended the depression. And during World War II, three new phenomena developed, which continue to influence our budget thinking and decisions today:

- ° Withholding of federal income taxes:
- ° Inflation driven "bracket creep" in the federal income tax system; and
- ° A national debt which by the end of World War II exceeded the nation's gross national product.

Almost no one thought we should retire the national debt at the end of WWII. It was too big. But almost everyone thought our post-war budgets should be in balance if not every year, then over some reasonable period of time. And from the end of WWII until the early 1980s our

national debt declined almost every year as a percent of GNP.

Revenues increased as the economy grew. Even small increases in inflation produced a "dividend" in the form of higher tax revenues to the federal government. We could increase spending. We could pass tax cuts. And while the budget rarely was in balance, the debt and interest cost in the budget declined relative to the size of the economy and of government; so they became more manageable.

Still, we worried about budget balance. The norm of budget balance was very important to the climate of constraint which produced a steady decline in the national debt as a percentage of the total economy.

We did pass new spending programs. We cut taxes from time to time. But we always believed that if we put government on automatic pilot -- if we passed no new spending or tax laws -- current policy would produce budget balance in the near-term future.

As recently as the 1980 presidential election, the issue was when and how, not whether, to balance the federal budget.

And this is precisely what we mean when we speak of the norm of budget balance. Almost everyone in the country -- politicians and their constituents, economists and political scientists -- accepted this as a given.

The budget debate has changed radically since 1980, and that is why we are here.

In 1980, President Reagan proposed to cut domestic spending, increase our commitment to national defense, cut taxes, and balance the budget by fiscal year 1984.

What happened?

Congress cut domestic spending less than the President proposed. We cut taxes more than the President's original tax bill would have done. (Incidentally, both of these outcomes were very predictable.) President Reagan's initial budget submission contained a \$50 billion per year negative contingency item representing additional budget cuts he promised to submit in subsequent years.

And then there was good old "Rosy Economic Assumptions." You remember "Rosy." She was the one who told us we could cut taxes more than we cut spending, tax cuts would spur phenomenal economic growth, and the budget would balance itself as if by magic.

But Rosy was wrong. We went through a deep recession in the early 1980s. We went into that recession with a structural deficit of about \$100 billion a year. We came out the other side with \$200 billion-a-year deficits as far as the eye can see.

Those of us who thought Congress never would pass a budget containing a \$100 billion deficit watched appalled as the constraints

with which we had always lived seemed suspended.

In 1982, and again in 1984 [and 1985], Congress and the President agreed on deficit reduction packages. But these were, essentially, holding actions. We cut spending. We raised taxes. But the deficit continues to hover around \$200 billion a year -- and this after three years of economic recovery.

The national debt began to grow as a percent of GNP in 1981. As a consequence of increased aggregate debt, plus high interest rates, interest costs grew as a percentage of total federal spending. All Congress and the President have done to cut the deficit since 1981 has been sufficient, just barely, to offset these increased interest costs.

Some supply-side economists and their adherents in Congress and the Administration would have us believe it doesn't matter. They support spending restraint. But they say: In the long run, economic growth will solve our deficit problem.

We don't believe them. We are concerned that on any realistic set of economic assumptions, the current policy deficit will continue to be about \$200 billion a year -- and if the economy should go into recession the deficit could be much larger.

Our Committee did not convene this meeting sooner because we were convinced the case was compelling: We believed, we continue to believe, budget balance over some reasonable period of time is important.

Given the current debate, however, we are convinced it is necessary to revisit first principles -- to ask the basic question: Do deficits matter?

Once again we return to Gramm-Rudman-Hollings. As I said at the outset, Congress and the President appear to have concluded deficits do matter, else why adopt this extraordinary legislation?

But their commitment to budget balance will be sorely tested as they explore the very hard choices necessary to produce a balanced budget -- even within five or six years, and even if the economy continues to grow.

Will the President decide next year that his defense build-up and his commitment to reduce tax rates are more important than reducing the deficit? That has been his decision in the final analysis every year since 1981. Even as he agreed to Gramm-Rudman-Hollings, President Reagan's primary focus was on its effect on the defense budget.

Will Congress conclude existing entitlements -- especially social security and medicare -- are more important than budget balance? They did when they devised the exemptions from sequester in Gramm/Rudman/Hollings.

Will the system break down because our political leaders cannot compromise their competing priorities?

Gramm-Rudman-Hollings is a high, or low, watermark in the history of

budgeting. Never before have so many labored so hard to avoid getting their hands dirty, to devise a mechanism for reducing the deficit for which everyone can disclaim responsibility, to avoid hard votes on hard choices.

But this is a Lewis Carroll contraption, truly a view through the looking glass, an illusion. The budget simply cannot be balanced by a series of automatic across-the-board cuts.

In the first instance, President Reagan will not agree to cuts in defense as large as are implied by Gramm-Rudman-Hollings. And he should not. We fearlessly predict Congress will discover soon that these cuts go far beyond their willingness to cut defense. Almost everyone agrees restraint on the rate of growth for defense must be part of a package to move the budget back toward balance. But almost no one wants to cut defense spending below last year's level in future years.

Because social security, medicare, and other large entitlement programs are exempted from sequester in Gramm/Rudman/Hollings, nondefense discretionary spending bears an unrealistic share of the burden of restraint. This will not work.

Because there is no automatic mechanism to raise taxes in Gramm-Rudman-Hollings, there is no way to avoid unrealistic cuts -- cuts that probably are unsustainable -- unless Congress and the President agree to an alternative to sequester or unless they abandon the deficit reduction goals they just adopted.

This meeting will try to answer six important questions:

- ° Is balancing the budget important economically?
- ° Is balancing the budget important politically?
- ° What is the relationship between fiscal and monetary policy?
- ° What is the effect of deficits on selected sectors of the economy?
- ° If balancing the budget is important, how can we get from here to there?
- ° What is the role of the media in the budget debate?

The Role of the Media

The media plays a very important part in any public policy debate in this great country of ours. Elected politicians often are judged by their constituents on the basis of the way issues and votes are reported in the press, on radio and on television.

In the budget debate, I must say the media has done elected officials and their constituents a disservice all too often. Issues are reported in simplistic, black and white, misleading terms. Votes are described as being: "for or against the President, for or against social security, for or against defense," and so on.

In all my years in the House, I don't recall any vote "against the

President," with the possible exception of the impeachment proceedings after Watergate. I certainly do not remember anyone in Congress voting "against social security," or "against defense."

On the other hand, the media often lets politicians get away with murder. A Congressman or a Senator votes for Gramm-Rudman-Hollings, for a balanced budget constitutional amendment, or for some totally bogus budget package based on phony economic assumptions and/or some strange form of "new math," and you report that they voted to "balance the budget."

I am especially pleased to see media representatives here as active participants in this meeting. Coverage of the budget issue in the media has improved in recent years, but we still have a long way to go before the American people will have a sound basis on which to base their opinions about the hard choices needed to move the budget back toward balance. I sincerely hope one outcome of this meeting will be better reporting, which I hope will help to create a climate of public opinion in which elected officials can solve the budget/deficit problem.

Conclusion

What I have said so far reinforces what most of you know are our Committee's biases. But we did not -- we could not have -- convened this group alone.

The American Association of Retired Persons, The American Stock Exchange, Avon Corporation, The Business Roundtable, General Foods Corporation, GTE Corporation, and the Kerr Foundation have joined us to make this symposium possible.

All of these groups share with us the alarm that the deficit rapidly is approaching crisis proportions. And we all understand we must participate to solve the problem. Either we are part of the solution or we are part of the problem.

When this meeting is over, perhaps we will all conclude the problem is not as serious as we think it is. If we could believe that, at least we could sleep better at night.

But if we are right -- if budget balance really does matter -- we hope this meeting will contribute to a new consensus: That the norm of budget balance remains very important to sound budget policy and ultimately to a sound economy in our great nation.

If that is the case, we hope sincerely everyone here will bear in mind: Norms operate because of general acceptance, not because we write them into statute -- nor even into the Constitution.

Gramm-Rudman-Hollings may bring pressure to bear on federal programs. It may even test our political system: the ability of elected public officials to muster popular support for hard, but necessary choices. Success in this effort, however, could restore public

confidence in our basic institutions of government.

Every time one of us argues some specific objective is more compelling than the overall goal of moving the budget back toward balance, we undermine to some extent public acceptance of the truly hard choices which will be required.

We want a balanced budget. We want to maintain a strong defense. We want to take care of the elderly and the needy in society, to provide adequate support for research and infrastructure, to protect the environment. These are not mutually exclusive desires. But they do imply a renewal of the social contract. We must decide what we want our government to be and do -- and how to pay for it, not just how to charge it to future generations.

We have here some of the best minds in the country. To make the decisions they must, our political leaders will require all the help they can get from people such as you.

We ask all of you, for the next two days at least, to put aside any biases you bring to this meeting. Let us explore together the knowledge and ideas we bring collectively to this symposium. We are embarked on a very important period in our history. Let us take advantage of this opportunity to prepare the way as best we can.

With that thought let me say thank you to all of you for taking time from your very busy schedules to take part in what we believe is a very important meeting, thank you to all of our co-sponsors in this endeavor, and thank you to Ted Brophy, who is our host tonight, and to whom I am going to turn back the microphone right now.

BROWSER'S GUIDE

Sessions I and II

Is Balancing the Budget Important Economically?

Is Balancing the Budget Important Politically?

Reading these two sessions together highlights the overlap between politics and economics in the deficit debate.

There is in the discussion no dispute over the need to move toward budget balance, but the priority placed on that goal varied, at least implicitly. Dr. Johnson and Representative Gingrich hated the deficit, but they also hated the thought of raising taxes to balance the budget. Only Dr. Modigliani said that balancing the budget was so important it mattered not whether it was done with taxes or spending cuts or both.

Although the first panel was about economics, ideology and political preference were evident once the discussion moved beyond the overall consensus that the deficit had to be cut. Some of the discussion was couched in economic terms but even much of that was political. It is as if making the argument an economic one will lift it out of the political arena and give it some added strength. At the symposium this technique was most often used by those arguing against including a tax increase in any deficit reduction package.

One question ran throughout both sessions: Can you force Congress and the President to do what they prefer not to do? When does the pain of specific micro-actions (like cutting programs) become less than the pain of failing to produce a package? No one had the answer. Dr. Buchanan and Representative Gingrich were pessimistic about the political system's ability to deal with the deficit problem. Representative Gingrich said: "Only crude solutions work...the elegant solution is like social drinking for an alcoholic...which clumsy reality do you prefer?" Dr. Modigliani challenged this pessimism: "Why do you think you are so much worse than your predecessors?"

Session II was explicitly about politics -- both partisan and institutional -- and budget balance. The small-p political schizophrenia inherent in the budget issue was more explicit in this discussion. As Senator Kassebaum pointed out, popular support for a balanced budget is overwhelming; so too is opposition to cuts in social security, defense, student aid, and a myriad of other programs. Representative Schumer, however, argued that the attitude has grown more sophisticated: His constituents no longer argue against all cuts but rather for cuts to 10% rather than 40% or against being singled out for cuts. This "everyone or no one" concept of fairness is another major thread in the budget debate. "Across-the-board" may not be a very sophisticated or analytic definition for "fairness," but it has come to have an intuitive appeal.

Participants disagreed on where the deficit stands in the public's concern. In his paper Norman Ornstein argues that while Congress is obsessed with the deficit, public opinion is flaccid. Kevin Phillips disagreed with

the polls, arguing that cutting the deficit was not a top priority. He agreed with Senator Kassebaum, however, that there was little understanding that cutting the deficit meant cutting "good" programs.

The President did not fare well in these two discussions. Most participants, regardless of partisan preference, decried his apparent unwillingness to compromise -- and his abandonment of the Senate Republicans in 1985. Representative Schumer commented that Congress as an institution was not created to lead but to serve as a check on the President. In the absence of Presidential leadership, a body of 535 was ill-suited to offer substitute leadership.

June Cross made a comment that perhaps should serve as an epitaph for the 1985 session of Congress: Balancing the budget isn't important politically; looking like you are trying is. Is this why the first session of the 99th Congress adopted a new process (Gramm-Rudman-Hollings) but let reconciliation die?

Before leaving these two sessions one note is in order. It would be a mistake to conclude that these discussions were discouraging about the future. The silver thread throughout the discussion was that there is a consensus package out there. The uncertainty was over how and when it would come to fruition.

Note:

Senate Budget Committee Chairman Pete V. Domenici and House Budget Committee Chairman William H. Gray III both prepared papers for the symposium and intended to participate in the meeting. Both the Chairmen and Senator Chiles, ranking Democrat on the Senate Budget Committee, were unable to attend. All three asked other members of their Committees to participate in their places.

We include in this volume the papers by Chairmen Domenici and Gray, as well as papers by Senator Nancy Landon Kassebaum and Senator Jim Sasser (who took the places of Senators Domenici and Chiles, respectively), and the edited remarks of Rep. Schumer, Chairman Gray's replacement.

FEDERAL BUDGET DEFICITS:
AN ECONOMIC PERSPECTIVE

by

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and

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U.S. Federal Reserve System

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Perhaps the most important current issue in the formulation of economic policy is whether or not large Federal budget deficits bring about high real interest rates and do harm to the economy. This issue has been debated intensively, and some have argued that the persistent large deficits in recent years and projected into the future are causing interest rates to be abnormally high, thereby posing a threat to continued recovery and to sustained long-term economic growth.

In order to analyze the possible effect of the deficit on interest rates and the economy, it is necessary to examine the role of the deficit in determining consumption and investment decisions in the private economy, as well as decisions concerning the composition of financial portfolios. Such an examination should take as its point of departure conventional macroeconomic theory.

The purpose of this paper is to clarify some of the theoretical issues involved in the question of whether or not the Federal deficit has an effect upon interest rates and the general performance of the economy and also to comment on empirical findings of the relationship between deficits and interest rates.

Deficits, Macroeconomic Analysis and Ambiguous Results

Traditionally, in popular discussions, deficits have been viewed as affecting primarily macroeconomic targets of aggregate demand and price stability. Recently the role of budget deficits as automatic or discretionary countercyclical stabilization tools has become controversial. Moreover, questions about the effects of government deficit spending on long-term real economic growth have become a focus of attention and contention.

The discussion about the consequences of budget deficits for economic growth often is phrased in terms of their effects on prices of goods, services and, especially, such financial variables as interest or

exchange rates. An examination of frequently encountered assertions about the causal links between deficits and interest rates reveals that, contrary to some widely publicized opinions, the effect of government deficits is by no means unambiguous. The outcome depends, among other things, on the assumption made about the saving behavior of the private sector. One framework of analysis notes that when taxes are cut and government borrowing is increased by an equal amount, some (perhaps all) of the tax cut will be spent on new government bonds.

The total amount of the tax cut will be used to purchase the new bonds if the taxpayer/bondbuyer perceives that the bond interest he receives will be used to pay the future tax required to service the government debt, and that the return of the principal of the bond will be used to pay the future tax required to retire the bond. In this case, leaving aside incentive and distributional effects, there is no impact on the interest rate whether government spending is financed by taxes or borrowing. This view, while still controversial, is not new -- it dates at least from David Ricardo in the early 19th century. And several recently completed empirical studies suggest support for this hypothesis.

The extreme opposite assumption is that there is no substitution whatsoever between taxes and borrowing by the government; extra after-tax personal income is devoted entirely to increased consumption, none is saved. Thus, no increase in private saving accompanies the additional government borrowing and thus the additional demand for loanable funds inevitably results in upward pressure on interest rates.

Other factors that exert crucial influence on the outcome are the extent to which: deficits are caused by spending increases or tax cuts; financing is accomplished by monetization of the debt or by sale of government debt to the public without new money creation; the tax cut reduces marginal tax rates thus improving incentives to supply productive labor and capital; the outlays financed by the deficits change the composition of government spending; and government debt is an attractive investment for foreigners.

The results are also influenced by the magnitudes of the private sector's various responses to the specifics of the policy changes and a host of institutional arrangements determining the adaptability of labor, product and asset markets to changing economic conditions.

These considerations indicate that short-term consequences of budget deficits may be very different from the long-term ones. I shall devote a few remarks to both.

Short-term Financial Effects

Some concerns about the impact of budget deficits on interest rates focus on very short-term financial effects, which, even if they do in fact occur more or less systematically, are of very short-lived and reversible nature. A surge in Treasury borrowing may raise interest rates briefly. However, at most it can be said that this temporary rise reflects the reaction of financial markets to short-term excess flow

demand for credit that must eventually (and rather rapidly) be eliminated by adjustments in the size and composition of accumulation of financial assets by the private sector.

These very short-run effects, while clearly of great significance to participants in financial markets, have minimal influence on the longer-term evolution of real economic variables and are, therefore, of relatively minor importance for formulation of economic policy.

Effects of Deficits on Cyclical Recovery

Some analysts assert that high current deficits will prevent or abort the ongoing economic Recovery. The argument behind this assertion is that big deficits cause high interest rates; high interest rates depress expenditures for output of interest sensitive industries; and the economy cannot recover unless those industries recover.

In discussing the cycle, it is clear that "passive" deficits which are the result of recession are matched by a decline in private sector borrowing, and are not likely to raise interest rates or prevent recovery. What seems to be at issue is the impact of "active" deficits which go beyond the normal cyclical levels due to deliberate policy changes.

The conditions under which big deficits do or do not cause high interest rates are discussed in the paper. But even assuming that big deficits do cause high interest rates, this need not derail the recovery. Reduced demand for some categories of output may be more than offset by larger expenditures for other categories of output (such as consumption of nondurables or defense spending). The strength of recovery depends on total production and sale of goods and services rather than particular categories of goods and services. In fact, it is widely recognized that an "active" deficit adds to total spending and thus aids the recovery to proceed apace. Depending on economic conditions (including the rate of money growth), the current deficit may put some upward pressure on interest rates or other prices. However, this would indicate that there is more than enough, rather than too little, aggregate demand relative to the available supply of goods and services.

There is no economic theory to support the assertion that a large current deficit will depress the economy. At most, a large deficit that adds to total spending and thus contributes to an upward pressure on the interest rate may also contribute to a bias in the composition of total demand against the output of interest sensitive industries, such as, for instance, housing. The extent to which this bias will be pronounced is an empirical matter.

Another assertion is that large expected future deficits will prevent economic recovery from recession. Aside from the fact that this last recovery has been both strong and sustained, the argument behind this assertion is as follows. Future deficits make expected future interest rates high. That keeps present long-term interest rates high,

because today people will not lend long term at rates that are below the rate they expect to obtain several years from now.

One version of the argument is that prospective deficits result in higher expected inflation, which results in expected higher nominal interest rates in the future, thus causing higher nominal rates now. But even if future deficits cause higher expected inflation (which is by no means self-evident), this argument implies that nominal -- not real -- interest rates rise. However, in a rational world high nominal rates should not restrain investment unless expected real rates also rise.

Effects of Deficits Over the Time Span of a Business Cycle

The foregoing discussion of the likely effects of government deficits on the prospects for recovery assumes, albeit not without caveats, that government deficits are responsible for high interest rates. However, the extent to which deficits affect interest rates in the medium term is a question for which mainstream conventional economic theories have only ambiguous answers.

Perhaps the most widely-used approach for analyzing intermediate-run effects of deficits on interest rates is the Keynesian theoretical framework in which an increase in the deficit brought about either by an increase in government spending or a reduction in taxes has the effect of raising interest rates. This happens because an increase in the deficit leads to an increase in aggregate demand, and hence, in nominal GNP. The increased dollar volume of transactions requires more money. If the Fed does not accommodate the increased demand for money, the velocity of circulation must rise, a result which is made possible by a rise in interest rates. It may be noted that in the Keynesian framework higher interest rates are associated with higher GNP, which is quite different from an assertion that high interest rates prevent GNP from rising.

Now, I would like to say a few words about the connection between deficits and the rate of inflation. Although deficits can be observed to rise while the inflation rate falls, it is possible that an increase in the deficit can put some temporary upward pressure on the price level even if the deficit is not monetized.

With no supply-side effects considered, an outlay increase or a tax reduction, resulting in an equal increase in the deficit, causes a temporary increase in inflation, a permanent rise in the price level and in real interest rates, and a permanent decline in investment. The price pressure will be self-terminating if monetary policy remains unchanged.

Acceleration of money growth, in an attempt to counter the upward pressure on real interest rates, would prolong and accelerate the rate of inflation. Evidence on the extent to which deficits have been monetized is mixed, but there are some data that at least suggest that in recent U.S. history there has been a positive relationship between the percentage increase in the privately held Federal debt and the rate of growth of the monetary base. However, Federal Reserve Board Chairman

Volcker has assured us that the current large Federal deficit would not change the conduct of monetary policy.

Crowding Out

Another critique of fiscal policy characterized by large deficits emphasizes the so-called "crowding out" effect of excessive government borrowing.

The term "crowding out" is used loosely in popular discussions to convey the notion of a displacement of private investment by government absorption of real credit. But this notion is misleading and the concept of crowding out is murky.

Because credit is scarce, it is rationed by capital markets, and so even if government is totally absent from capital markets, some potential borrowers are crowded out at any level of interest rates. Crowding out thus occurs in the process of market allocation of limited credit to the users about to pay the highest prices. But if, for instance, increased government borrowing is due to a corporate tax cut, cash flows internally generated by corporations will increase, and their credit demands will decrease commensurately. Also, the financial market process of crowding out does not contain any normative implications; that is, for a given level of government spending no general assertion can be made that financial crowding out is more deleterious to the economy than alternative methods of financing a given level of government expenditures.

The unique role of the government in crowding out other potential borrowers is not due to the sheer size of its credit demands. Rather it mainly reflects the facts that the government borrowing is interest rate insensitive, and that the government borrows to finance activities that predominantly do not add to future productive capacity. Since government spending is, from the standpoint of generating future growth, mainly nonproductive, it preempts some resources which otherwise could have been used for investment purposes. Rather than a financial phenomenon, the reduction in private investment and consumption reflects the resource allocation required when increased government expenditure demands compete with private investment and consumption for limited amounts of labor, capital and other productive inputs. Preemption of these productive factors by the government is sometimes labeled real, as distinct from financial, crowding out. Thus, apart from incentive effects, the impact of government spending on the economy in the medium term is the same independently of whether this preemption is financed by borrowing or by taxes.

It is also worth noticing that crowding out by the government, be it financial or real, need not necessarily have its major impact on business investment rather than households' consumption. All that can be said is that interest-sensitive spending by the private sector is reduced relative to noninterest-sensitive expenditures.

Incentive Effects

Incentive effects -- the increase in the supply of productive factors caused by improved incentives resulting from cuts in marginal tax rates -- are most important when the tax cuts are permanent. A tax cut financed by government borrowing may be viewed as temporary to the extent that the borrower expects that tax rates will be raised to retire the debt originally issued to finance the tax cut. Thus, a tax is more likely to be viewed as permanent when accompanied by a reduction in government spending. To the extent that a tax cut enhances economic growth, government borrowing to finance the tax cut will be less likely to crowd out private investment. This is because higher growth means, first, more tax revenues to partly offset initial revenue losses, and, second, more saving to meet the additional supply of government bonds. Therefore, there would be less upward pressure on real interest rates and on prices, resulting in more private investment and a different consumption pattern.

Short Remarks on the Long Run

Finally, I would like to offer a few brief remarks on the connection between government deficits and prices (including interest rates and exchange rates) in the long run. This problem is analytically very interesting, empirically intractable and extremely important from the standpoint of formulating appropriate policies.

One can only speculate on the effect of continuing deficits on interest rates and, more fundamentally, on economic growth.

In brief, for some combination of elasticities of supply of labor and private savings, a given structure of marginal taxes, a composition of government expenditures (in terms of growth-enhancing and growth-retarding categories), and other parameters, there will be some sustainable level of secular budget deficits relative to GNP, that is, essentially, not resulting in an explosive growth of the debt-to-GNP ratio. It is not possible to state a priori what that level might be but it need not necessarily be zero. The sustainable deficit-to-GNP ratio would be higher the greater are, among others, the responsiveness of supply of labor and output-to-capital ratios; average marginal taxes; and the proportion of productive investments in total government spending. But satisfactory econometric estimates of these parameters do not exist yet.

However, simulations (performed by IMF economists among others) based on a range of reasonable values of relevant parameters indicate that the effects of tax rates cuts on the supply of aggregate output, while rather weak in the short run, may, in the long run, dominate the demand, i.e., the stimulative, effect. Therefore, it appears that the secular trend of deficits, if kept at a sustainable level may be more conducive to economic growth than if the corresponding amount of funds was raised by taxing the productive factors in the economy.

Finally, even if one were to accept the proposition that continuing

high deficit-to-GNP ratios cause high interest rates, one could not conclude that these high interest rates will unavoidably result in slow economic growth. If tax cuts and tax reforms geared toward creating economic incentives, rather than increases in non-productive government spending, are the prime reason for deficits, high real interest rates may have no discernible effects on the rate of economic growth. In fact, evidence abounds that during periods of economic buoyancy and optimistic expectations, as, for instance, in the 1920s and 1960s, high investment levels and concomitant high growth rates may prevail for long stretches of time despite high (real) interest rates and vice-versa, low (real) interest rates prevalent, for instance, in the 1970s by no means guarantee high investment levels or robust growth.

Empirical Studies

The theoretical analysis presented so far indicates that the effects of an increase in the deficit upon interest rates are ambiguous; larger deficits can coincide with either higher or lower interest rates.

Econometric -- statistical -- attempts to discern systematic relationships between deficits and real interest rates (while controlling for other influences such as the growth of money, business cycle effects, and effects of risk due to volatility in money growth) have failed to establish reliable evidence of such a relationship. Consider, for example, two recent studies by researchers who represent somewhat different approaches to macroeconomic analysis: Princeton University Professor Alan Blinder and Ohio State University Professor William Dewald who is editor of the Journal of Money, Credit, and Banking. If you like labels, Blinder is a Keynesian, while Dewald is a monetarist.

Dewald, in a January 1983 paper published by the Federal Reserve Bank of Atlanta, concludes that, "the high real interest rates in 1981 and 1982 are attributable to much higher and particularly much more variable inflationary expectations than normal," and, he continues, there are "a variety of credit market factors" which "offer a more promising explanation of high real interest rates than budget deficits which have been found to account for very little of recent high real interest rates."

In his December 1982 National Bureau of Economic Research Working Paper, Blinder says that on the basis of his statistical analyses, "The hypothesis that growth in debt does not help predict real GNP growth cannot be rejected" and "in sum, neither growth in bank reserves nor growth in national debt carries much information that is useful in predicting future real GNP growth."

A recent study by University of Rochester Professor Charles Plosser finds that increases in government spending raise interest rates, whether financed by borrowing or taxing. He finds that substituting taxing for borrowing to finance the same level of government spending has little impact on bond prices or interest rates. Thus, to reduce interest rates, spending must be cut.

Finally, the Treasury Department's comprehensive 1984 study entitled

The Effect of Deficits on Prices of Financial Assets: Theory and Evidence concluded that a systematic relationship between deficits and interest rates could not be established. This finding resulted from a thorough review of the existing literature and additional statistical analysis.

Conclusion

Even though the relationship between the deficit and real interest rates and economic growth remains an open case, I am seriously concerned about future deficits because they are projected to be too large a share of GNP even though tax receipts are simultaneously projected to be at or near historically high levels -- between 19 and 20 percent of GNP. In this situation my conclusion is that Federal outlays must be trimmed. I prefer this course for several reasons.

First, a tax increase may simply buy more spending rather than less deficit. For example, the Administration consented to a \$100 billion tax increase in TEFRA in exchange for nearly \$300 billion in outlay reductions. Initially, only \$53 billion in spending cuts were voted by the Congress. Subsequent budget resolutions have reclaimed even those cuts. Now, however, it appears that the Congressional budget resolution this past Summer and the recent Gramm-Rudman Amendment have put Federal outlays on a declining path relative to GNP without the threat of a tax increase.

Second, a tax increase probably would not be effective in reducing interest rates. Moreover, a business tax increase would have a direct and adverse effect on investment spending by reducing the rate of return on plant, equipment, and structures, while an individual income tax increase would discourage investment by small unincorporated businesses, and would reduce savings and raise labor costs, which would also retard investment and growth.

The case for raising taxes is based on the assumption that it will cause saving and investment to expand relative to consumption spending. The theoretical analysis and empirical evidence on this supposition is not convincing, and I believe that my skepticism is warranted.

In my opinion, the growth of Federal outlays should be slowed so that it runs about 20 or 21 percent rather than close to 25 percent of GNP. This goal should be a continuing priority of the Congress as it considers spending legislation in the years to come.

THE ECONOMIC CONSEQUENCES OF THE DEFICIT

by

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Introduction

I appreciate this opportunity to present my ideas on the economic consequences of debt-financed budgetary deficits. I say this because my ideas are not widely accepted by my fellow economists, and, indeed, my ideas are much closer to those that emerge from the common sense of the ordinary citizen. These ideas were initially developed in my 1958 book, Public Principles of Public Debt (Irwin), which challenged the then-orthodox Keynesian notion that public debt involves no temporal shift of burden because "we owe it to ourselves." My basic ideas have not changed over the course of three decades, but the importance of the subject matter has changed. It is far more important in 1986 than it was in 1958 to get the fundamentals of analysis correct. My second major effort was a book, Democracy in Deficit (Academic Press), written jointly with Richard E. Wagner, and published in 1978. This second book did not examine the economic consequences of debts and deficits; it did, instead, explain why modern or post-Keynesian democratic decision process generates quasi-permanent deficit financing. Whereas the first book was an attack on the Keynesian macroeconomic theory of public debt, the second book was an attack on the Keynesian presuppositions about democratic politics.

It is not surprising that my efforts in both cases ruffled the feathers of economists, who continue to remain dominated by the macroeconomic mindset imposed by the mid-century Keynesian "revolution" in economic thinking. I shall not, in this paper, continue my ongoing argument with other economists, but some mention of my adversary stance is helpful as background for the subsequent discussion.

The Elementary Principles

In its simplest terms, the economic consequences of a debt-financed budgetary deficit are equivalent to the economic consequences of a debt-financed deficit in the account of any economic-financial unit, whether this be a person, a family, a corporation, a club, a church, or a labor union. When current revenues fall short of current outlays or expenditures, a deficit emerges; and if revenues are not increased or outlays decreased, the deficit or shortfall must be financed by borrowing. (With national governments, which possess money-creation authority, budget deficits may also be financed directly by money issue. I shall leave this possible revenue source out of the discussion here, since the relevant subject matter involves the consequences of

debt-financed deficits. These consequences may, in themselves, make some ultimate resort to monetization more likely, a point that I shall touch on briefly below.)

For both the borrower and the lender, the sale and purchase of debt instruments involves a temporal displacement in the availability of funds. The borrower is enabled to spend more than revenue or income in the initial budgetary period, but is obligated to spend less than revenue or income in some future period. The lender spends less than revenue or income in the initial period but is enabled to spend more than revenue or income in periods during which the debt is amortized. And, as I have argued for three decades, the government is not different in these respects from any other borrower.

A return to the primer is required because of the massive confusion in much of the discussion of public debt and deficits. If we rule out default (and I shall return to discuss possible default later), the primary economic consequence of debt-financed spending by government is the guaranteed necessity that we must, as citizens-taxpayers-program beneficiaries, give up some part of our incomes in future periods in order to meet interest and amortization charges on debt. A share of our future incomes is obligated to meet the legitimate claims held by creditors of the government. And it makes no difference whatsoever whether these creditors are themselves citizens or foreigners.

The financing of current government spending by debt is equivalent to an "eating up" of our national capital value. If we define a capital value by discounting an expected stream of future incomes, then any offset against such future incomes reduces this value. And it does so in precisely the same way that consumption of a capital asset would. By financing current public outlay by debt, we are, in effect, chopping the apple trees for firewood, thereby reducing the yield of the orchard forever.

The analogy between debt-financed public consumption and the destruction of capital value is often rejected because, it is argued, with internal debt held by citizens, the obligations against future incomes embodied in public debt are just matched by the claims held by those who have purchased the government's securities. In this simplistic macroeconomic logic, therefore, there is no effect on capital values summed over the economy. The absurdity of this argument is demonstrated once we recognize that those who purchase the securities do so in a wholly voluntary exchange transaction, and that, precisely because the purchase is voluntary, these same persons might have used the funds either to purchase other income-yielding private assets or for initial-period private consumption. In either case, the capital values of claims held by those who purchase the government securities cannot be counted as positive offsets to the negative capital value that is necessarily embodied in the obligation to meet future interest and amortization charges. This negative value is a charge against the portfolio of citizens, as members of the political unit, and it is not matched by any offsetting positive increment to the capital value appropriately assigned to this same portfolio. This result holds quite independently of the sources of the initial funds loaned to government.

Domestic and Foreign Debt

This basic logical error in analysis informs the familiar argument that debt claims held by foreigners, so-called "external debt" is more onerous than those debt claims held by citizens or domestic organizations. The error here stems from a failure to consider the alternatives initially faced by the purchasers of securities. If debt instruments are bought by citizens, alternative uses of funds in the domestic economy are foreclosed. If the bonds are bought by foreigners, these alternatives in the domestic economy remain open. The claims against future income held by foreigners in the second case here are precisely equivalent to the value of the uses of the funds that remain available for exploitation in either private investment or consumption opportunities. As citizens, as members of the political organization of government, we are in exactly the same position whether the national debt is held by persons inside or outside of the national economy.

It is often suggested that the 1980's regime of massive deficits has been sustainable without major economic damage only because foreigners have purchased large blocs of the securities issued to finance the deficits. Otherwise, it is suggested, budget deficits of the magnitude experienced would have exerted unacceptable upward pressures in interest rates. My conclusion about the equivalent effects of foreign and domestic debt does not contradict such a suggestion. The impact of a debt-financed deficit, of any given size, on the rate of interest will depend on the supply of loanable funds, and if foreign investors supply funds for domestic loan markets, public or private, the rate of interest will be lower than it would be if such foreign investment funds were not made available. It makes no difference at all as to whether foreigners purchase private or governmental securities.

Crowding Out

A second major source of confusion, or at the least, of ambiguity involves the "crowding out" issue. Since debt financing requires government to sell securities in exchange for funds supplied by lenders, funds that are then used up when government spends, it seems evident that these funds might have been used by the lenders to purchase income-yielding private claims. Prospective sellers of private securities (e.g., firms seeking to expand capital facilities by floating new issues of stocks or bonds) are "crowded out." Private securities can be marketed only at interest rates that are much higher than those which would prevail in the absence of the government borrowing operation.

This seemingly straightforward argument has been challenged by some economists who suggest that the issue of public debt, in itself, stimulates new savings. According to this argument, citizens will recognize the future-period tax liabilities that are embodied in any issue of public debt. They will, accordingly, adjust their behavior so that these future tax payments, which will be imposed either on themselves or their descendants, can be more easily met. In this scenario, persons, who observe government borrowing, will put aside additional savings by reducing current rates of consumption spending.

The additional saving will, to the extent that it takes place, match the additional demands on loanable funds that the public borrowing operation represents. In the limit, if the new saving offset is complete, there is no "crowding out." And, even if not complete, any new saving generated as a result of public debt issue will make the crowding out of private capital formation less than the initial argument might suggest.

My own position is that whether or not debt financing of budget deficits "crowds out" private investment and capital formation is essentially a secondary rather than a primary consequence. By labeling this issue to be secondary, I am not suggesting that it is unimportant. I am suggesting, instead, that economists' undue concentration on this question, to the almost total neglect of the more important primary effect or consequence of debt is inexcusable. In order to emphasize my position here, let me, strictly for the purposes of discussion here, assume that no crowding out occurs at all. Assume that there is no effect of debt-financed deficits on the rate of interest, and, hence, on the rate of capital formation in the economy. This result would require that new savings are generated just sufficient fully to finance all of government's debt instruments offered.

The primary economic consequence of debt-financed deficits would still be present, even in this extreme, and totally unrealistic case. There will be a net claim against future private income flows in the economy, a claim held by creditors of the government, all those persons, individuals or organizations, domestic or foreign, who hold government securities. Taxes, which are by their very nature coercive, must be levied against persons in order to generate the revenues that are required to finance the interest charges on the debt. That share of private incomes that must be devoted to tax payments cannot, by definition, be available for private disposition as individuals might desire, acting in either their private or their public capacities. The burden of having to make the tax payments from personal income streams will be present, quite independently of the behavior of those who make the initial-period decisions as to how much to save and to consume. The person who, faced with a tax bill to finance interest charges, will not make any relationship between the saving that his father may or may not have made because the debt was issued earlier. The person, faced with such a tax bill, will reckon only on the simply observed fact that income that he might otherwise use is taken away in taxes. The result is precisely analogous to the apple orchard example introduced earlier. If the yield of three trees under a person's nominal ownership is committed to debt service, it is fully equivalent to having an orchard with three fewer trees.

How Long Can We Tax the Future?

The descriptive implications of the elementary analysis is clear. The federal government has embarked on a debt-financed spending spree that cannot be permanently sustained. The fact that the government cannot go bankrupt in any sense analogous to a person or business firm does nothing to modify the central proposition. Government's ultimate taxing and money creation powers can, of course, guarantee that all

nominally-valued debt claims will be honored, but neither an ever-increasing interest share of tax revenues nor an inflationary monetization of nominal debt claims offers a viable option for permanent reform.

The budgetary deficit must be reduced. But what are the consequences of this reduction? Current rates of government spending must be cut back, perhaps dramatically, and/or current rates of tax must be increased, perhaps dramatically. Either of these steps, or any combination of the two, must also have serious economic consequences. Spending cuts will reduce expected benefits to all those persons and groups that have come to anticipate continued program expansions. Tax increases will reduce incomes available for private disposition by individuals, some share of which would be devoted to private investment.

A reduction in the deficit, financed by either a cut in rates of government spending or an increase in rates of tax, could be predicted to lower, somewhat, the rate of interest, because the reduction in government's demand for loanable funds would not be fully offset by a reduction in the supply of such funds. This effect on the rate of interest is, again, a secondary consequence of the reduction or elimination of the deficit. The primary consequence is the shift of the incidence of payment for government programs from future period taxpayers to those taxpayers who are around during the period when the government outlays are actually made.

At some point, this shift in the temporal incidence of government spending must be made. Real growth in the national economy can postpone the day of reckoning, but interest charges cannot permanently take up an increasing share of the federal budget.

Do We Need to Change the Rules?

But is there much prospect that our democratic decision procedures will accomplish this shift in incidence? Must we not predict that these processes will operate to insure that the deficit dilemma get much worse before it gets better? Having embarked on the debt-financed spending spree, will our political structure, as it is currently organized, measure up to the challenge that it faces?

I do not think that it can do so. Or will do so. As we can all observe there seem to be almost insurmountable political costs involved in either spending cuts or tax increases. Modern American politics operates in accordance with a set of rules that makes effective resolution of the deficit issue almost impossible. The implication should be clear. Improvement or reform can only be expected to occur if the rules are changed. It is on this conviction that I have long been a strong supporter of proposals for a constitutional amendment to require budget balance.

I shall not develop the argument for such an amendment here. I have done that many times before, and that is not my assignment. I want, instead, to take a "realistic" perspective and to examine what seems now,

in 1986, to be the most probable scenario. Despite what I might, personally, hope for, I do not now predict enactment of an enforceable balance-budget amendment to the constitution within the next decade. Further, I do not think that congressional precommitments in the general Gramm-Rudman form will prove effective. There may well be quasi-successful short-run congressional attempts to reduce the size of the budget deficits, without changes in the basic decision procedures or rules. These efforts may, however, actually be counterproductive over the long term because they may, to the extent that they are successful in the short term, serve merely to distract attention from the structural-procedural reform that is required. Any such short-term congressional restoration of effective fiscal discipline could be and probably would be dissipated rapidly by return to fiscal profligacy. Recognizing this prospect, why should political leaders incur both political and economic costs now for the benefit of political leaders and constituents who come along later?

Prospects for Default

What then, can we realistically expect? Continued expressions of concerns about debt-financed deficits with little observed success in doing much about them? Mounting interest charges that consume larger and larger shares in federal budgetary outlay?

At some point in such a sequence, default or repudiation of the national debt must become a central political issue. Since the United States national debt is almost exclusively denominated in dollars, the real value of this debt can be reduced dramatically, in the limit to zero, by money issue. There are two ways that default through monetization might take place. First, the Federal Reserve monetary authority could simply purchase all outstanding government securities with new-created dollars. All creditors would, in this setting be guaranteed full nominal values of their claims. The inflation generated by the new money issue would reduce the real values of all fixed claims in the economy; the operation would be equivalent to a tax on all holders of such claims. Alternatively, the monetary authority could generate inflation by issuing additional money through ordinary channels, and in this way reduce the real values of all nominal debt claims outstanding, public and private. The effects would be almost equivalent to the first operation; the effective incidence will be on all holders of fixed claims. The second of these operations is more likely to take place than the first, and with accompanying denials by all concerned that there is any explicit intent to default on the national debt.

The relationship between national debt and another round of inflation deserves somewhat closer attention. Inflation will act to reduce the real value of national debt outstanding; the debt as a share of GNP might level off and even fall. For this reason, all comparisons between sizes of national debt and GNP are highly suspect, since the ratio of debt to product can be reduced dramatically by massive inflation. Such a policy thrust must, however, prove much less effective (from the government's perspective) in the late 1980's and early 1990's than it did in the 1970's. Outstanding debt is now more concentrated in

short-term issues, and inflationary expectations would very quickly be incorporated into interest rates. As the government would attempt to roll over and refinance maturing issues of debt, interest charges would rise to match the anticipated inflation. The apparently beneficial fiscal results would be largely short term in nature.

As some point in the sequence, more explicit repudiation of the national debt would surely enter into political discussion. And the failure of almost all commentators on the deficit, including economists, seriously to examine debt repudiation seems to me analogous to whistling past the graveyard. When we do consider default seriously, the arguments against such a drastic policy change are not nearly so strong or self-evident as many of us might hope they were. I cannot fully develop these arguments here, on either side, but let me put the question as follows: Why should taxpayers-beneficiaries who live in the year 1990 or 2000 be coerced into paying for the public program benefits that we, as taxpayers-beneficiaries in the middle 1980's, have used up? Why should these future-period taxpayers (which may, of course, include many of us) pay for the spending spree? I have looked at this question in some detail, and the strongest argument I can find against default lies in the acknowledged legitimacy of the claims held by the creditors. Those who are purchasing the government securities, and who have purchased them in the past, do and have done so in the expectation that their claims will be honored. To repudiate such claims would amount to a violation of contract, and we like to live in a legal system in which contracts are honored. But governments have often broken contracts before, and when all is said here, with whom did the creditors contract? I do not want to suggest that the arguments in favor of repudiation of the national debt will become politically dominant. I do suggest that default will become increasingly discussable as the debt-finance spending spree continues.

Default would, of course, call a halt to new borrowing, at least for a time, since lenders would become quite scarce. Note, however, that repudiation of the debt would eliminate the large interest component in the budget. Hence, once we get past the threshold point where the annual interest charges exceed the annual deficit (which is not far off), it will actually be in the short-term interest of current-period taxpayers-beneficiaries to default.

Conclusions

Both our fiscal and our monetary structures are currently in disarray. And, as members of the body politic, we are all behaving irresponsibly in our unwillingness to look at, analyze, and ultimately to support structural reforms that offer the only prospects for permanent improvement. We have allowed a quasi-independent monetary authority accidentally to attain a monopoly over fiat money issue without effective market or political control. Who can predict a random walk, which is the best modern characterization of the sort of monetary system we endure? Alongside this random-walk monetary authority, we have a fiscal structure from which almost all pretense of balancing off the costs of taxes against the benefits of spending has been removed. The problem is not, however, with irresponsible political leaders, either in the executive or

legislative branches of government. The problem is that the rules of the game are such as to make fiscal responsibility and fiscal prudence beyond the limits of the politically feasible. Constituents enjoy the benefits of public spending; they do not enjoy paying taxes. The politics of the deficit is as simple as that.

The tragedy is that so many of recognize full well what is happening and remain powerless to do anything about it. I have often called for a genuine "constitutional revolution," but how can we move toward its realization?

Let me finish, however, on a somewhat more optimistic note. The proposed amendment for budget balance has been seriously discussed for a decade, and at relevant political levels. Gramm-Rudman at least expresses a recognition of the necessity of fiscal precommitment of some variety. Economists, finally, are coming around to examination of basic structural changes in our economic and political institutions, and notably in our monetary and fiscal structure. These are all probably necessary precursors to reform in fiscal and monetary rules. If, and this is a big if, we can only get on with such reform before it is too late.

REPRESENTATIVE NEWT GINGRICH

January 10, 1986

Are budget deficits dangerous? Sometimes yes, sometimes no. The bias of the 18th and 19th centuries was clearly anti-deficit, except in dire emergencies. In the 20th century, the bias of the liberal welfare state has been pro-deficit. The contrast between pre-liberal welfare state America and modern liberal welfare state America is startling. Dr. Alvin Rabushka, Senior Fellow at the Hoover Institution, points out in his book, From Adam Smith to the Wealth of America, that from 1795 to 1811, America cut its national debt of \$84 million to \$45 million. Following the War of 1812, America had 18 years of revenue surplus and nearly paid off all of the national debt by 1836. After the Civil War, there were 28 surpluses in a row and the national debt dropped from \$2.7 million to \$960,000.

The 19th century commitment to hard money, limited government and annual surpluses was replaced in the 1930's by the liberal welfare state vision of soft money, centralized bureaucracy and government borrowing. The liberal welfare state financed itself by steadily increasing deficits.

Since 1960, there have been 24 deficits in 25 years. In 1962, the U.S. government owed \$300 billion. This year, it owed 7 times as much - over \$2 trillion dollars. Interest on the debt is now the third largest single item in the federal budget.

These deficits indicate that the real key to the liberal welfare state was not a redistribution of income among classes, a la Marx. The real focus of the liberal welfare state has been to redistribute income among generations. In the liberal welfare state version of generational redistribution, this year's politician gives money and services to this year's voter by pledging the resources of future voters. There are no incentives for current fiscal discipline because no one in the current generation will pay the future bills.

In effect, liberal welfare state politicians have a credit card whose bills come due in a future generation. Yet, the future generation is not able to vote on what to buy with that credit card. The result of this kind of generational redistribution has been the radical growth in transfer payments. In 1952, the figure was \$44.4 billion. In 1978, the figure was \$218.7 billion. Rabushka notes that during these years, population grew 39%, personal consumption grew 153%, and total government expenses grew 800%.

While the contrast in spending philosophy is evident, it's not clear that the 18th and 19th century focus on balanced budgets was fairer and healthier than the 20th century focus. To really know if deficits are bad, we need to know the circumstances that created them.

Historically, there have been only three sensible reasons to go into debt. First, a nation at war may have to finance the war with deficits.

second, it may be good to have a budget deficit if there are high private sector savings rates. In this case it may, in fact, be wise to sell government bonds to absorb the current private surplus as a form of investing in government. Alexander Hamilton's use of the national debt in the 1790's was based on this economic principle. Finally, a nation could go into debt to fund a project that might benefit our children and grandchildren. A program which borrowed from current income to create a more productive and prosperous future might make a great deal of sense.

The liberal welfare state fails on all three counts. America is at peace. We do not have massive private savings. Under the liberal welfare state, U.S. tax policy and government programs discourage savings and encourage borrowing. The result is a private sector savings rate that is miniscule by historical standards, anemic compared to our level of world trade, and vastly insufficient to fund our national debt. We are not using the debt as a tool to invest in the future of our country. Instead, the current liberal welfare state deficit is used to cover current services. Far from improving the future, the cost of the welfare state, including transfer payments, is crowding out infrastructure investment and technological progress that might improve our future. If anything, the liberal welfare state deficit is going to be a massive burden on future Americans and their ability to create new opportunities and new wealth. Now we are faced with the question of how dangerous is it to run a deficit year after year?

We know from history large deficits lead to large crises. When a nation consistently spends more than it earns, it eventually finds itself in deep economic difficulty. America is approaching just such a crisis. The rise of the global money market, the large flow of capital from Europe and Japan, and the influx of Third World upper class money has allowed the U.S. to manage its deficits without a liquidity crisis of severe proportions. Americans have been consuming resources borrowed from our neighbors around the world. We have lived better than we have earned.

How serious a danger is the potential for a fiscal heart attack due to a liquidity crisis? In pre-1929 language, we would call it a "panic." What would happen if the Europeans and the Japanese came to fear that American was not able to pay its debts and stopped their investments? The result would be a classic liquidity crisis in which the Federal Reserve system would have to boost the value of the dollar by allowing interest rates to skyrocket. Or, it would have to increase the money supply to 1980 Carter administration inflation levels or worse. There does not seem to be a good alternative to foreign investment without drawing down the already low domestic savings accounts. In short, after 200 years, we have returned to the conditions of 1790 when the Dutch financial market kept the U.S. debt afloat.

This crisis is not inevitable. There does not have to be a financial crisis due to the debt if the American economy grows rapidly enough that foreign investors continue to feel the dollar is a strong investment. If investors conclude the American economy is strong enough to back its debt, they will probably continue to keep their investments flowing.

However, the morning foreign investors conclude that America is not capable of growing out from under its debt, there will surely be a run on the dollar and, in turn, a liquidity crisis. The key, then, to America's financial stability is to maintain a healthy economy so no one fears our ability to pay off our debt. It is important for our general economic growth that we move to 5 new principles that should govern a modern approach to the deficit.

1. Implementing the Gramm-Rudman-Mack plan for cutting the deficit over the next 6 years.
2. Investing in the future rather than merely buying services for the present.
3. Solving the problems of redistributing the wealth of future generations to present voters.
4. Resisting the pressure to adopt protectionism as a solution to the trade deficit instead of a pro-growth, pro-export policy.
5. Resisting the temptation to raise taxes as a solution to the deficit problem.

First, Gramm-Rudman-Mack may be proof that, as one humorist put it, we wanted to balance the budget in the "worst possible way, and we succeeded." As unelegant and clumsy as Gramm-Rudman-Mack is, it is the only system of deficit reduction we have been able to pass. It is the best chance we have of balancing the budget before financial disaster shatters the U.S. economy. Therefore, every citizens group interested in balancing the budget should fight to make Gramm-Rudman-Mack successful. They should be aggressively vigilant against efforts to avoid or weaken its commitment to deficit reduction. With sufficient citizen support, this law will prove to be the path back to a balanced budget.

Second, in shrinking government spending, we must distinguish between current consumption and investment in the future. We should favor the latter. Our ability to defend freedom, compete in the world market, participate in the information-industrial revolution, provide growing real income, improve standards-of-living for our children and grandchildren, pay for the health care and retirement of our parents and grandparents, and carry the burden of our national debt requires that our spending priorities change. We must learn that building a space station instead of propping up inefficient social service programs will provide a greater return on our investment. We must learn the value of scientific research, and we must learn the value of building new infrastructures instead of maintaining old bureaucracies.

Creating an Opportunity Society will require reversing the biases of the liberal welfare state. An Opportunity Society will almost always lean toward favoring an investment in the future over higher consumption in the present.

Third, despite the political dangers involved, we simply have to confront the problems created by the generational transfer of wealth.

For two generations, the liberal welfare state's equivalent of a "pyramid scheme" worked well. America came out of World War II wealthy enough and with large enough advantages in technology that we could sustain living beyond our means. However, for 35 years, our competitors saved more, worked harder, and invested more in economic growth than we did. Now, we can no longer afford to spend at the expense of saving and investing for later.

Longer life spans and slower population growth also guarantee that we must rethink our ideas about retirement and then restructure our programs to fit the new reality. We must face the fact that our pension programs including Social Security must be reformed. Adopting Congressman Arlan Stangeland's Fair COLA Plan would be a good first step toward real reform.

Fourth, the pressure for protectionism in America relates directly to the concern for jobs. Without a chance for better jobs, workers will cling to the old, but certain, jobs. Without adequate adult education and training, workers will remain committed to dying industries offering no future for them. Workers read articles about European export subsidies and the realities of Japanese trade practices and react angrily. The emotional reaction to the threat of unemployment easily overrides the academic argument for an open American market in a world in which other markets are clearly regulated.

Only by creating a competitive, dynamic, job producing, growth oriented American economy can we avert the pressures of protectionism. That is why every budget issue and every tax question would be carefully examined for its impact on jobs and growth.

A multi-billion dollar budget cut that eliminates our aerospace research, our advantages in creating jobs, our scientific research base, and our infrastructure investment is a cut that guarantees growing protectionism. On the other hand, a budget cut that eliminates current consumption while deliberately protecting or even increasing investments in economic growth is a budget that enables America to avoid protectionism.

The question of economic growth transcends the question of America's ability to compete with Japan and Germany. A growing America will be able to absorb the Mexican, Brazilian, and Argentine imports, which are necessary for those countries to pay off their huge debts to American banks. A decaying America will elect politicians committed to withdrawing from the world market. Such a withdrawal could trigger a bank crisis comparable to that of the 1930's.

Creating tax, regulatory and budget conditions necessary for economic growth is the current challenge to American government. This approach is the only one which will sustain world trade and the world banking system.

Fifth, the requirement of changing from the liberal welfare state to an opportunity society and of maintaining economic growth prohibit any significant tax increase. The Washington establishment will never change

spending priorities from present consumption to future investment if they can avoid it. A tax increase allows them to avoid setting priorities and to continue to appease special interests instead of setting priorities. Similarly, politicians will not address the fundamental challenges of reforming our retirement systems and generational redistribution of wealth as long as they can avoid it. A tax increase buys more time for the politicians at the expense of the nation.

A tax increase large enough to help with the deficit is a tax increase large enough to cause a recession. That recession will probably trigger a war of protectionism, which may in turn trigger default by the Third World debtor nations and a monetary crisis. It's clear that a large tax increase would be the worst possible medicine. We would have treated the cancer of deficits by triggering a heart attack. Ironically, a tax increase would actually increase the deficit by lessening revenues due to loss of jobs and world trade.

Thus, such a tax increase would have effects similar to the Smoot-Hawley tariff. Eventually, it could lead to the economic debacle we are seeking to avoid.

In closing, deficits do matter. The deficit of the U.S. government is irresponsible and unsustainable. We must shrink the debt but with a constant commitment to economic growth in jobs, and take home pay. We have all studied the lessons of the 1929 crash. We all now that we must do better and avoid the same fate. Now is the time to prove that we can do it.

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1986 Nobel Laureate

January 10, 1986

My task is more to discuss the other papers than to give my own. I would like to discuss primarily the paper of Mr. Johnson, because I have more disagreement with him than with the other speakers, with whom I broadly agree with some exceptions. Mr. Johnson and I disagree with a few exceptions.

After all his reasoning that the deficit makes no difference, his final conclusion is that the deficit is too high. We agree on that. We also agree on one technical point: the very over used argument that high interest rates which come from the deficit make for low investment, low demand, and thus for a contraction is pure garbage.

I don't know why so many people, even economists, accept this complete nonsense. It is just like the old argument that the rise in demand will produce a great fall in supply because the rise in demand will raise the price; and when the price rises, then the demand goes down. So the final effect of the shift in demand is to have less output. It is exactly the same argument. As long as you've got the pressure that comes from the deficit, you have high interest rates and high demand. The high interest rates will reflect the high demand.

Other points of disagreement really range all over the place, including his reference to the possibility that when the deficit is larger, people save more. This is the so called Ricardian equivalent, and Johnson refers to it as having been invented by Ricardo. Ricardo, however, pulls out this argument and then refutes it, saying: "that's irrelevant for the world; the world just isn't like that."

The real issue is, to me, the problem of the deficit is not all kinds of garbage but one key point: does it displace investment? I think Buchanan and I said the same thing in a slightly different way. Of course product differentiation means each one advertises his own, but there is no fundamental disagreement.

Whether or not interest rates rise at the same time the deficit grows depends on many other circumstances. However, if you find that when the deficit is there consumption does not decline because of the deficit, and therefore private savings decline, then national savings decline. Investment may or may not decline. It depends on whether or not we borrow abroad, but in reality that makes no difference. When we borrow abroad, instead of having less physical capital, we have the same physical capital and more debt. For future generations the effect is exactly the same: there is no real difference where we borrow.

The only issue that's relevant is displacement, whether or not the deficit decreases consumption for a given tax level. The evidence seems to me to be very clear. I've written five papers on the subject: two of these are published; three are in publication. One was published about twenty years ago, and in it I showed in terms of stocks that government debt displaces private capital.

In other words, total wealth does not rise when the government runs a deficit. Therefore, it displaces capital. The total isn't changed, and that's exactly what my life cycle theory of saving predicts. It predicts that people decide how much wealth to hold on the basis of what they themselves need for tomorrow, including their own desires to bequeath what they wish. Certainly the last thing they do is go and consult how much the government is in debt.

There have been many other papers. There is one paper that purports to show that consumption does decrease with the government deficit. I have written a comment on that paper which will appear in a few months. I show that the deficit does not affect consumption at all, not even a little bit, as I think the theory says.

I have also looked at a cross section of countries. I have looked at about 35 countries to see whether those countries which have more deficit consume less. Answer? Very small. When the deficit rises, there is 20 percent more savings and the rest comes out of investment, comes out of national savings. That seems to me to be the really important issue.

I agree that it is interesting to study the case of interest rates, and I think that this will require much more study. Most of the studies done so far have been incomplete. Of course there are qualifications to this reasoning, and I have written them before. Mr. Johnson says the effect of a deficit depends upon a number of factors, but he does not give the one really, really important qualification: is there a lot of slack in the economy?

If there is a lot of slack in the economy, then it is true that the deficit has nothing to displace because there is more output to be created. There is nothing to displace, so you don't push out anything. That is true, although I have shown that in the long run there is an effect which can be washed out by that kind of balanced budget which I favor.

I am against constitutional amendments, and I don't favor balancing the budget every year -- why not every minute or every second? There is only one concept that makes sense: balancing over the cycle. You should run deficits when you are in the low phase that supports income. You should have surpluses when you are in the high phase that will hold demand down. I favor that.

Now since the time is short and there will be time in the discussion, I will skip most of the other details on which Mr. Johnson and I disagree. Let me give you one other important area of disagreement.

Mr. Johnson says that if you have a reduction in business taxes and you create a deficit, nothing happens because then the firms save more. Why should firms save more when they have higher profits? Do they save 100%? I always thought that when profits increased, firms distributed that between retained earnings and payments to the stockholders, depending on their financial need.

Similarly, there is a reference to the fact that if you raise taxes on investment, the effect is less investment. No, Mr. Johnson, that is completely wrong. The effect is to lower interest rates. Why do you think we have the high interest rates we have today? One reason is the deficit. The other is the great reduction in business taxes, which of course enables people to pay a higher price. Investment can change only when savings change. Raising taxes makes absolutely no difference. It might create short-term problems, but given some time, saving is the only thing that matters. If you change taxes, you change interest rates, not investment.

One word about Mr. Buchanan. I have emphasized the fact that the deficit displaces investment and, therefore, the future income of future generations. We are essentially depriving the future of capital. That proposition is, of course, the same as saying that the future will have to pay more taxes. They have to pay more taxes, while at the same time not having more revenue. If they had used that money to make investment, people who receive the interest would receive it out of the capital. When you have used it to pay for government expenditures, people receive the interest out of other people's income. That's where the taxes come. It's the same basic argument. I would disagree with Buchanan on this point.

I think by and large, I agree with Mr. Gingrich in his pessimism about the outlook for the deficit. Maybe I'm older than he, but I've seen all kinds of things. In our long history, we have had very sensible government until 1980 or maybe until 1982. In the beginning President Reagan was wise about the deficit; it became wide later.

Remember that in this country we have hardly had any deficit of any significance, except purely short term deficits due to sharp contractions. Except for those, we have had very little deficit, especially if you correct for the effect of inflation. Between 1950 and 1980, the deficit as a fraction of GNP went from about 1.3 percent in the war year of 1945 down to .3 percent. That is why, incidentally, it is a good policy to have a balanced budget: because if the economy is growing, with a balanced budget the debt will tend to decline. Unfortunately we do have calamities, war and the like. So every now and then you get a spurt, and you have to have a policy which in the normal years creates a reserve. Then when a catastrophe comes, you have reserve.

Only one last remark. I agreed with almost everything that was said by Mr. Gingrich until he argued against raising taxes. I want a balanced budget, that's the one thing I do want. I don't care. You can pursue it with a spending cut or raise taxes. I think we need a compromise.

I have nothing against nothing. Everybody else seems to say the

deficit matters less than something else. I think it is the one that does matter. Where I disagree with Representative Gingrich very much is when he says raising taxes would create a depression. There's absolutely no reason for that any more than cutting expenditures would create a depression. It's exactly the same thing. If you believe what he said, you must be absolutely against cutting out anything, including your secretary's allowance for pens. There is no difference whatever between raising taxes and cutting spending. If you reduce the deficit, there must be an accommodating monetary policy. Given that, there is no reason for any contraction. Thank you.

IS BALANCING THE BUDGET IMPORTANT ECONOMICALLY?

Discussion

Panelists:

Hobart Rowen, Syndicated Columnist
Jonathan Fuerbringer, The New York Times
Ann Reilly, Fortune Magazine

HOBART ROWEN: I don't think the question should be put in terms of balancing the budget. That's the wrong perspective. In part we get that from Gramm-Rudman-Hollings. What we should be thinking of instead is balancing the economy: balancing the budget by reducing the deficit within a balanced economy. Franco Modigliani has given us many of the reasons why we should not always think in terms of a strict budget balance, which would work to the disadvantage of the economy. Nevertheless, today it is important to pursue a very substantial reduction in the deficit, not because it is necessary to have neatly balanced accounts, but because the deficit has become so basic to many things in the real economy.

The trade deficit and the overvalued dollar have flowed directly from the large budget deficit. As Congressman Gingrich has said, it has led to a loss of jobs and a loss of markets. A great part of our problem in the Third World, especially in Latin America, is due to the fact that our export industries are no longer able to sell in those markets. The deficit compounds the Third World debt problem and, as anybody from a farm state knows, compounds the farm problem. It generates protectionist pressures. The deficit has become so big -- and this is another good reason to reduce it -- that it adds an interest burden each year larger than total government outlays used to be.

A large deficit means that the government is dissaving maybe 4¹/₂ to 4-1/2 percent. That's a lot of money. We can't afford that in an economy where private savings aren't substantial enough. We need total savings to generate the investment Professor Modigliani was talking about, and that's why it's important to reduce the deficit. But you don't have to go crazy. You don't have to lock in an exact balance on a rigid time scale like Gramm-Rudman-Hollings that ignores other events in the economy.

Congressman Gingrich made an important point on the reason we are able to sit here and pay our bills: We are sucking the capital and savings from the rest of the world at a rate that just can't be sustained.

At some point that is going to stop. The trouble with Gramm-Rudman-Hollings is that it doesn't do things in a rational way. It says, in effect, that we really don't trust ourselves to make intelligent decisions. Of course, that's part of the burden of what Dr. Buchanan was saying. I'm not willing to give up and say that we aren't smart enough to handle this problem of the deficit. We've handled many other problems in the history of this country, and there's no reason why we shouldn't be able to handle the problem of the deficit without doing it in such an

arbitrary and, I really believe, stupid way.

The rigidity of Gramm-Rudman-Hollings is a little like the rigidity of the monetarists who say you have to work by a rule, set a clock and don't pay any attention to sensible steps. Further, I believe Gramm-Rudman-Hollings is only one short step away from an even more foolish way to handle the problem: the constitutional amendment.

JONATHAN FUERBRINGER: First of all, as to the question whether balancing the budget is important economically, with some of Bart's reservations, I think the answer fairly clearly is yes. Even Manny Johnson gets around to that point grudgingly in his paper and certainly in his oral presentation. Yet, for the Reagan Administration, and for other people who talk about the importance of balancing the budget, but have a lot of conditions on how to do it, the arguments for minimizing the deficit are political as well as economic.

Manny's original paper on this (which I believe was in 1984), was basically a product of Treasury Secretary Donald T. Regan trying to argue that interest rates were not affected by the deficit. What he was really doing was arguing against proposals to cut the deficit with a tax increase and/or a defense cut opposed by the President of the United States.

While you can make the argument that reducing the deficit is important economically, it seems that argument is most convincing when the economy is in bad shape.

Reducing the deficit is important for another reason: the underlying arithmetic, just the very simple fact of compound interest on the national debt. We are going to have to come to terms with that, no matter what. Today interest costs are some \$150 billion, almost equal to what some people call the discretionary portion of the budget. There's just no way to get away from that arithmetic. In some ways, this may help. People are going to find it easier to agree on the damage of escalating interest payments than on the relationship between deficits and interest rates.

What is happening in Washington right now, despite the fact that the Reagan administration came in in 1980 with a promise to balance the budget, is a debate over priorities. Getting rid of the deficit may be very important; people talk about it. However, it seems quite clear that the Reagan administration would rather have future generations pay the bill for today's defense budget and today's tax cuts, including those for the wealthy, rather than give up those policies.

The debate on the deficit and whether it's important to reduce it economically really comes down to a debate over priorities. Most people's arguments are a reflection of their own priorities. Ronald Reagan probably puts his defense budget first, maybe tied with or slightly ahead of his opposition to tax increases; and deficit reduction for him is after that. I believe that he would be perfectly willing in the end not to have major deficit reduction if that's what it takes to

preserve the 1981 tax cuts and his defense budget.

That is where Gramm-Rudman-Hollings comes in. I guess I disagree with Bart. Bart says that Gramm-Rudman-Hollings is going to force Congress and the Administration to do things that they don't really want to do. I think that's the whole point of Gramm-Rudman-Hollings. The reason we can't reduce the deficit is we have been unable to get people in Washington to agree on a compromise, which includes a lot of things that all sides do not want to do.

Certainly Gramm-Rudman-Hollings has a great many bad points, including how ugly and irrational its automatic spending cuts would be. But that's part of the design of Gramm-Rudman-Hollings. The intent was to make those automatic cuts so ugly and so irrational that maybe in the interim, between now and when those cuts go into effect next October, the White House and Congress will come to some kind of agreement. In the end, however, it is still a question of priorities. Until you get agreement on priorities, you're going to have people disagreeing on the edges as to whether it's important to move toward budget balance, because they want to protect their priorities.

ANN REILLY: For those of us covering budget policy in Washington, there is a really fundamental irony. The budget reporters, Congress, and economists all seem totally obsessed with deficits, yet the economy seems to be doing well, and people seem to greet this whole debate with what I see as a really big yawn. You probably couldn't get this many people together anywhere else to talk about the budget, certainly at this hour. Nevertheless, from my perspective, deficit reduction is extremely important for reasons that already have been mentioned here: trade, future interest costs, and our ability to govern ourselves.

I think that the Gramm-Rudman-Hollings process does change the dynamic in Washington and does create new pressure on Congress and on the President to come to some sort of agreement. I don't think the sponsors will get what they want, but I do think the law changes the dynamic in an important way.

I would like to address a question to the panelists. What would be the impact of Gramm-Rudman-Hollings if the targets were achieved as Reagan would like, i.e., if we were to achieve something on the order of \$50 billion in spending cuts for FY 1987? Would this encourage growth? Would it slow the economy? What would it do? On the other hand, if the target is met with some sort of a compromise including both spending cuts and tax increases, what impact would that have? What would the best kind of tax increase be, if we finally get down to that? Is a value-added tax the way to go, or would it be better to go for an oil import fee or some other sort of tax? What would the impact on investment be? I think as we go into the year, the discussion will shift to taxes more and more, and it's important to think of what kind of taxes would be the least onerous for the economy.

DR. MANUEL JOHNSON: First, some people have lost sight of the fact

that the Reagan administration has always placed a very high priority on a balanced budget. There's no doubt about it. We are faced with very large deficits now, but you have to remember that we have tried over and over to propose spending reductions corresponding to the tax rate reduction and defense policy that the Administration pursued. You cannot deny the fact that the Reagan Administration has seen this as a major priority. We have just been very unsuccessful at getting our domestic spending program through the Congress. We continue to see the priorities the same way.

I find it inconceivable that we can sit here and think about solving the deficit problem by going back to excessive amounts of Federal taxation and funding a government larger in size and scope than we've had in the past. Anyone who thinks that is going to produce an improvement in economic efficiency over the long run has to be mistaken. I find it inconceivable that an increase in business taxes to close off the Federal deficit, given the size that it is now, would have a zero impact on investment. Clearly, general increases in taxes on capital would reduce the productivity of capital and, therefore, reduce the amount of investment, because the marginal product of capital is reduced. Clearly this would lead over time to a reduced capital stock. It would also lead initially to a lower real interest rate reflecting the lower return on capital.

I certainly concede that the real interest rate is higher today because of lower taxes on capital and higher marginal product of capital, which leads to an expansionist capital stock and more demands for private credit in order to expand capital stock. And that would work exactly in reverse if we were to raise taxes on capital to deal with the deficit.

It's just as obvious that it would produce extremely deleterious effects on the economy if we were to try to solve this problem on the tax side. The Administration's position throughout has been that the size and scope of government was too large. We wanted to reduce the government's presence in the economy by cutting back on Federal spending and putting those resources back where they could be put to more efficient use: in the private economy. The priorities for doing that were not only tax rate reduction, reducing tax rates on capital, increasing the marginal productivity of capital and capital stock and leaving it to an expansion of investment, but also a matching reduction in domestic spending so that we would have a balanced budget and not have to face the problems associated with the growth of debt relative to income.

We continue to want to pursue those policies, and I think that you'll find this Administration continuing to insist that this is the way to economic prosperity. Now obviously we're in a transition period where we have a deficit, but we're arguing about the priorities here. It's not that we like what's going on out there. We simply think that the priorities we pursue -- lower taxes, smaller government -- are the way to deal with the problem and lead to economic prosperity. I agree there are interim problems created by this, but the stakes are high in where we end up.

DR. JAMES BUCHANAN: I want to respond to the last question Ann Reilly raised. My perspective is not the current macroeconomic consequences or impact on the economy. My concern is a structural, longer-run concern. What would happen, she asked, if we did use a tax increase to balance the budget or to reduce the deficit? My concern is not so much the impact of immediate recession but that if we increase taxes, and this is particularly relevant if we use a broad-based tax without at the same time generating a fundamental change in the rules, i.e., a constitutional amendment for budget balance, we simply are creating an engine of government growth. The worst possible scenario down the road would be a value-added tax which would be a guaranteed instrument of larger and larger government. That's what concerns me, not so much a short-term impact on growth, but building in an instrument of government growth.

I argued in early 1984 that Mr. Reagan should have offered a trade to the Congress: "OK, let's have a tax increase to balance the budget, but give me the constitutional amendment." That is a trade he could have gotten. I think it would have been a good trade. I'm not opposed to tax increases to move toward budget balance, if we have the constitutional amendment. But without it, I think the tax increase is simply a generation of further government growth.

REP. NEWT GINGRICH: I wrote this up because I was fascinated with both Professor Modigliani and Bart Rowen. I understood for the first time what I think has happened to decision making and analysis in our society. Our intellectual elite can devise solutions more elegant than our body politic can sustain. It is as though 1986 research scientists were trying to teach 1789 doctors to perform surgery. Theoretically, I agree with Rowen and Modigliani. As an academic historian at a faculty seminar, I could argue for balance over the economic cycle and laugh at the shibboleth of a balanced budget dogma. However, free societies, and especially the extraordinarily cumbersome division of power system devised by the founding fathers, make it virtually impossible to have an elegant academically acceptable solution.

Furthermore, the macroeconomic principles of Modigliani, which are true, are defeated by the micropolitical incentives of politicians. Politicians in the bad years will run deficits. In good years also politicians face powerful pressures and temptations from constituents and elections to run deficits. Once we accept the legitimacy of stealing from our children and grandchildren to reward our immediate voters, we are on a binge. Yes, Gramm-Rudman-Hollings math is crude. Yes, an annual balanced budget in non-wartime years is a crude and economically simplistic goal. However, if it is true that our political system is clumsy and inelegant, if it is true that borrowing from our children is an addiction like alcoholism, then only crude solutions will work.

Alcoholics Anonymous teaches that you cannot drink socially if you're an alcoholic. The Modigliani/Rowen thesis of elegance and economic sophistication is to American politicians the equivalent of social drinking. We simply can't do it. Either we will have an irrational but real bias in favor of inflation, spending, and borrowing

or an irrational but real bias in favor of limited government, balanced budgets, and private investment. As a student of both the history and the practice of power in America, my challenge to Professor Modigliani and to Bart Rowen is: Which clumsy possibility do you prefer? Don't ask us politicians to do that which is theoretically right but undoable. Tell us which reality is less destructive or more desirable.

DR. FRANCO MODIGLIANI: I find it necessary to remind our Representative of what he said himself, that in previous history there was no such addiction by Congressmen, politicians, Congress in general. They knew that one must not encroach on future generations unless there were a very strong and very special reason. Why do you think suddenly you got so much worse? I believe you are just as good as before. The problem is that you have a President for whom the highest priority is not to change his program. That's much more important than balancing the budget. That is an exceptional situation which leaves you in a completely unique gridlock which you must try to break in some way.

I think it's been suggested that some new coalitions be formed. I don't see any reason why that has anything to say about the future. I think that future Congressmen will go back to being virtuous, as they always were. Some of you may remember the time of the Kennedy attempt to reduce taxes and create a deficit. There was no way of selling that to the American people. The American people were very conscious then.

Right now, we have created a sense of "everyone for himself." "Think of yourself, and therefore, to hell with the future." OK. The deficit is raising taxes on the future. We are not talking about whether we should raise taxes or not. The question is: Do we raise taxes on us, or do we raise taxes on our children? That's the only choice we have. I am optimistic about this country. I have adopted it as my country, and I'm very proud of it. And I think, fundamentally, it is a rational country with rational political figures. I don't think we need any of that pessimism about ourselves.

Let me add that I had suggested a cyclically balanced budget. That, in principle, is something you could legislate. What it means is that you look at the deficit which would result in any one year if there were full employment. That's a perfectly feasible calculation; and I would even be willing to go along with making that a constitutional amendment, with proper qualifications, but not an amendment for an annual balanced budget.

Let me add to what I said before about the effect of the deficit. There are at least two other immediate effects. One is the whole complex situation of the overvalued dollar, our inability to export, the protectionist crisis. If we reduce the deficit, interest rates will go down, the dollar will go down, and the problem will disappear; maybe not immediately, but it will disappear. The second problem is the debtor countries. We have not said anything about that. Their plight is awful unless we can reduce the deficit and interest rates with it, I have no doubt at all that if you cut the deficit down \$100 billion, interest rates will take quite a leap down. That's the other issue of today.

It's a reason why today we need to cut the deficit, and I say not \$30 billion, but \$100 billion.

VICTOR MILLER: Most of you up there are talking about inter-generational equity. Isn't it really an issue of current equity where rather than taxing people to pay for government, we're borrowing much the same money from much the same people and paying them for the privilege and using up our broad-based tax for that purpose?

REP. NEWT GINGRICH: I think that the whole problem is clearly going to come to a head a long time before we switch generations. I think, as everyone up here has said, the question is: How do you want to finance the spending in which you are going to engage? Do you want to finance it by raising the taxes now? Do you want to finance it by borrowing the money, which means you're going to have to raise the funds later and pay off the interest? Or do you spend less?

I keep emphasizing, candidly, the intergenerational borrowing, because I think it is the younger generations who will coerce us to go back to being the virtuous politicians of the 19th Century. They were virtuous because, if you look at Gladstone and the others, they believed in raising taxes immediately, if necessary, to balance the budget. They believed in cutting spending immediately, if necessary, to balance the budget. They had a mythology that you shouldn't borrow from your children.

Now my argument is for us as politicians. I'm just speaking here as a politician; I'm not an economist. I am arguing that as the baby boom generation and their children realize who will pay our bills, you're going to see the political pressures for solving this thing escalate radically. These next two generations, who are just now entering the political market in a large way, are both suddenly going to look at spending the rest of their lifetimes paying off their parents' spending. In my judgment, as that begins to be articulated -- and I think it will be by the 1988 Presidential election -- you will see a dramatic shift towards an imposition of a balanced budget of some kind, whether it's cyclical or annual.

RICHARD BRANDON: This whole thing really comes down to taxes and spending. We're all dancing around that fact. I also want to respond to a point I think is economically absurd but politically very potent: this continual argument that if we raise taxes, we just get more government spending. Yes, if we create a major revenue generator like a value-added tax, in and of itself, it will create a lot more government spending because there will be no pressure to cut. However, if we're talking about a tax increase as part of the package, that doesn't hold true.

Further, as someone who for the last eleven years has spent a lot of political blood over cutting a billion dollars in this or that program, let me say that painful as it is, it was a lot easier when we had small deficits. When you had a \$16 billion deficit, it was easy to withstand

pressure for even a \$1 billion increase. A billion dollars throws us further out of whack. When you have a \$200 billion deficit, you cannot hold off that pressure. How can anybody accept the argument that their billion dollars makes a big difference? I really think that we have to bury somehow this argument that taxes as part of a package generate more government spending. It doesn't wash; it doesn't match our political experience.

JONATHAN FUERBRINGER: I'd like to add to that. People forget we've been on a spending binge anyway. Defense spending has gone through the roof. We're spending a lot more in total. The budget's a lot larger than it was five years ago. There's one other thing to note: only Mr. Modigliani, of those who presented here, has said, "I'm willing to do anything to cut the deficit. I don't care what it is, if it's taxes or spending, just let's put something together and do it." Everyone else here, reflecting his priority, has certain policies or programs they want to protect more than they want balance. I just think that emphasizes the problem. Mr. Johnson has his priorities; Mr. Gingrich has his priority; Mr. Buchanan has his priority. He's worried about spending. I don't know how we get the panel to address this, but when does there come a point at which you have to compromise your priorities and to get something done?

HOBART ROWEN: Dr. Johnson said a minute ago that we shouldn't solve the problem on the tax side. To follow up on what Jon was saying, let me say we don't have to solve it on the tax side, but you can't solve the deficit without doing something on the tax side. It doesn't have to be all one way or all the other way. But certainly it has to be some combination of both. Most of the members of the panel, except for Dr. Modigliani, were arguing that you ought to do it entirely on the spending side and leave taxes alone. That's where I get off their bandwagon. You have to have a combined approach, not to balancing the budget, but to reducing the deficit, and that's what the problem is.

DR. FRANCO MODIGLIANI: I think Mr. Fuerbringer said it very well, that the best way to solve this problem is to get away from the present and past, in which the President says, "I hate deficits, but raising taxes is much worse." And one part of Congress says, "I hate deficits, but cutting military is much worse," and the other says, "I hate deficits, but cutting social programs is much worse." Out of that comes the "much worse"; you end up with a deficit. The only way we're going to get out of it is by saying, the deficit is going to be no more than x. And on this I would agree with the approach of Gramm-Rudman-Hollings, except we should go much faster, because we need to make room now, not in five years. But then, given the numerical goal, we should try to get together on cutting spending with the understanding that whatever we cannot cut will come out of taxes, automatically. So everybody will face the true dilemma which is between taxes and expenditures, and not the wrong dilemma pitting expenditures and taxes against the deficit.

PAUL DUKE: I would like to pick up on Jonathan Fuerbringer's point about priorities and pose a challenge to Manny Johnson. You were saying just a moment ago that the Administration has made balancing the budget one of its major priorities, and the problem has been that you can't get the spending reductions the Administration has requested. It seems to me that in one sense that is theoretically true, but in another sense it is really not true. It is like saying that you can solve the problem of highway fatalities in this country if you ban automobiles from the streets. The Administration has proposed a number of spending reductions which are just politically unacceptable. They're politically unacceptable to Members of Congress and, it also seems to me, to the country at large. That makes it very hard to argue that balancing the budget has been a realistic high priority for the Administration.

DR. MANUEL JOHNSON: Well, first, I think you're partly right that we've been unsuccessful in getting our priorities through on the spending side. There has never been any intent to shift the burden to future generations; there has always been an attempt to pay for the changes in fiscal policy that came from tax reduction by cutting domestic spending. That was the original Reagan platform. It always has been, and we've been politically very popular on the basis of that. I think that we have had some successes on the domestic side. One of the major problems we've had on the spending side over the course of this Administration has been the fact that the 1981-82 recession was so severe that we are still dealing with the fallout from the spending effects from the recession as well as the revenues lost due to declining incomes during that period. It has been very difficult for us to offset that.

Still I would not say we have been unsuccessful completely on paring back domestic spending. We do have further to go now because we have had to deal with a recession on the front end of this Administration. I don't think, and I know the President doesn't think, that the American people are telling him he has made a big mistake on his priorities. We are continuing to insist on those priorities.

Wait until you see this domestic budget next month; we will let the political process work itself out. We still perceive the priorities in this country to be reducing the size and scope of government and the disincentives that result from big government, keeping lower tax rates on capital and labor, and paying for that by reducing domestic spending. We are going to put that set of choices to the American people over and over again. I think that if we go back to raising taxes to pay for various spending programs, then we're going to have to deal with the potential economic effects on the system. Then obviously we would have some additional excess capacity resulting from a weaker economy due to the tax increase. We have to take that into account. If we raise taxes enough, we may be constantly in a cyclical deficit situation.

JAMES T. MCINTYRE, JR.: I wasn't going to say anything, but I have to make a comment on the last statement. First, I think it is important to note that the size of government has not been reduced. We're talking about spending 25 percent of GNP now. We have to stop dancing around

this question and really confront it head on. We have not reduced the size of government. Furthermore, the cuts that have been proposed by this Administration do not equal the total of the recommended increases in defense spending and cuts in revenues. I think we have to confront that issue and stop dancing around it with rhetoric. This is not a partisan observation. Roy Ash and other Republicans -- some of whom are here today have made exactly the same point. We really have to deal with the problem of the growth of government spending.

IS BALANCING THE BUDGET IMPORTANT POLITICALLY?

by

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Chairman, Committee on the Budget
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January 10, 1986

As one elected official who has expended a great deal of time and energy in the pursuit of reducing Federal deficit spending, I obviously must conclude that bringing Federal revenues and expenditures more into balance is vitally important. It is important, as it relates to some basic precepts of this government, it is important for the future of this country, indeed to the world, and therefore it is important politically.

The purpose of this paper is to review briefly why I believe a more balanced Federal budget is important politically, and to conclude with an overview of how that has been (and is likely to be) translated into legislative action.

The Democratic Political Economy

As I look back over the last few years, it seems the Congress has been almost continually embroiled in the budget debate. In fact, I would note that the issues of deficit spending and proposals to reduce the deficit really began during the early years of the Carter administration. The focus on the deficit was a central theme of the 1980 Presidential elections and, of course, ushered in the major deficit reduction proposals of the Reagan administration in 1981.

I think, however, that we need from time to time to step back from the immediate fray, and calmly and rationally discuss how all this talk of deficits fits into a much larger picture. With all the attention paid to the budget debates and the numbers, particularly over the last five years, I sometimes think that we lose sight of the simple fact that behind the numbers and the deficit projections, lie some of the most fundamental issues any free democratic form of government can address. For you see that while the economics are important, the issue is really not economics, it is almost entirely political.

The politics of the budget -- the politics of balancing the budget -- are intertwined with those principles of government that were debated and discussed almost two hundred years ago in Philadelphia in the formulation and adoption of our Constitution. And, as this paper is being presented today, some of those same issues are being debated in a Federal District Court of law over the constitutionality of provisions in the recently adopted Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings).

These "political" issues go to the heart of such long-standing

controversies as: the separation of power between the executive and legislative branches; Federal and state responsibilities; private and public rights; economic equity (social justice) versus economic efficiency; access and non-access to the decision making process.

A recent report issued by the Committee on the Judiciary states that no concept is more a part of traditional American fiscal policy than that of the balanced budget. The requirement of budget balancing under normal economic circumstances was considered part of our "unwritten constitution." To our founding fathers, expenditures in excess of receipts were considered to be in violation of basic moral principles.

Now all this may sound somewhat odd coming from a Senator who has been almost entirely enmeshed in numbers and figures, but I truly believe that the budget trade-offs -- the issues surrounding the balancing of the budget -- can be categorized into these various political issues fundamental to our democratic political system.

Any debate on balancing the budget cannot be argued strictly on economic grounds. Given the uncertainties and vagaries of economic forecasting, it would be politically foolish to do so. The deficit debate must address the political issues I have outlined above. It must, therefore, address the type of government we wish for ourselves, but most importantly for our children and future generations.

The budget then represents the culmination of these innumerable policy decisions and mixes of policy, and has become the focal point for addressing the problems, desires, and wants of the electorate. The budget deficit, simply put, remains the foremost policy and political problem confronting the nation.

Current Political Pitfalls in Balancing the Budget

While I sincerely believe that the Federal deficit must be significantly reduced, no one is more aware than I of the tremendous political risks that await the politician who charges ahead to balance the budget while ignoring or unaware of the intricate relationships that have developed over the years between Federal programs and the recipients of those programs. Obviously, one of the most sensitive political issues this last year, as an example, was over efforts either to freeze or otherwise slow the rate of growth in the Federal retirement programs, particularly Social Security.

In an effort to adopt a Federal budget that was judged to be "fair" and treat all programs equitably, plus make a significant impact on the deficit, fifty Senators cast very courageous votes early one morning last May 10th on a budget that would have frozen all COLAs, including Social Security, for one year.

The budget that passed the Senate that early spring morning was the largest and single most important deficit reduction plan ever adopted in this country's history. Did it achieve a balanced budget in the projection period? No. Was it the correct policy for addressing the

deficit? Yes. Was it good politically? It could have been. But in the negotiations that followed to reach a compromise with the House's budget, the Administration removed its support for the Social Security COLA freeze, and the correct policy decision quickly became the wrong political decision.

All this is simply to say that the political hardships associated with the decisions the Congress and the President have to make toward balancing the budget can be made into political victories if political compromises can be achieved, or conversely they can be made into political nightmares.

It seems axiomatic that with political courage, ingenuity, and some vision of the future (not just the focus on the next election) has in the past and can in the future fashion a deficit reduction plan that can garner broad political support even though specific elements of it would be painful. Balancing the budget would then be not only good public policy but also can be good politics.

Certainly courage and vision will be needed in the upcoming year if we are to formulate a budget that meets the targets specified by Gramm-Rudman-Hollings. For it is without question that to meet the Fiscal Year 1987 target deficit of \$144 billion, down from what could easily exceed \$200 billion this year, and to avoid the complete repudiation of Gramm-Rudman-Hollings by the Administration, serious bipartisan and Administration agreements will need to be reached very early on defense spending, domestic spending, and revenue increases.

The political irony could be that if such an agreement is not reached, and if the President were to decide that in his position as Commander-in-Chief he could not sign a sequester order that would reduce defense spending by between \$65 and \$90 billion next year, that the political gains some felt had been made by Gramm-Rudman-Hollings this last December could quickly become the anti-incumbent act of this fall.

No one should suggest that balancing the budget is without some very tricky political undercurrents. But I, nevertheless, continue to feel strongly that bringing our expenditures and revenues into better balance is the correct thing to do politically. If we do not find a political solution to this problem then I believe we risk violating one of the most basic precepts of good government as stated by Jefferson at the beginning of this Republic, and that was that the profligacy of one generation ought not forever to burden its successors. As one commentator has recently observed, we are quickly becoming a nation divided between the young and old, and one of the legacies children appear to be inheriting from their parents is a diminished standard of living. This is not good policy, this is not good politics.

THE POLITICS OF A BALANCED BUDGET

by

Senator Nancy Landon Kassebaum

January 10, 1986

Is balancing the federal budget important politically? The answer to that question -- at first glance -- would certainly appear to be a straight-forward "yes."

For at least the last twenty years, public opinion polls have consistently indicated that a huge majority of all voters support legislative or constitutional action to mandate a balanced budget. Popular support for the general proposition is overwhelming.

That being the case, it would be logical to assume that politicians, in their eagerness to champion to the most popular economic issue of our times, would have balanced the budget long ago. As everyone has undoubtedly noticed, that hasn't happened. Over the past twenty years, the deficit trend line for the federal budget has moved steadily further into the red. Why?

Although public support for a balanced budget is overwhelming, public support for the large cutbacks in specific programs that would be required to balance the budget is almost non-existent. Consider the following survey results of the Conference Board published last August.

Ninety-eight percent of all Americans oppose significant cutbacks in Social Security and other retirement programs -- that's one-fourth of the budget. Seventy-one percent oppose major reductions in spending for national defense -- that's almost one-third of the budget. Ninety-seven percent of survey respondents are against significant reductions in spending for health and Medicare -- that's 10 percent of all spending. By majorities of from 3-to-1 up to 9-to-1, the public opposes reductions of any significance in student aid, farm programs, unemployment benefits, roads, highways, aid to small business, spending on child benefits, and public transportation. Interest payments on the debt, which equal almost one-sixth of the budget, can't be arbitrarily reduced. Together these programs represent approximately 90 percent of all federal spending.

Those programs that the public believes should be cut--food stamps, foreign aid, and welfare in general--could be completely eliminated with negligible long-term effect on the deficit. The general public perception, however, is that the elimination of such unjustified "give-away" programs, combined with the elimination of waste, fraud, and abuse, would easily balance the budget.

In short, the public has demonstrated an extremely strong and remarkably consistent political preference for two mutually exclusive policy objectives -- increased federal spending for over 90 percent of all federal programs and a balanced federal budget. To make the picture

complete, it should be noted parenthetically that over the past ten years a majority of all voters indicated they believed that taxes were too high.

The political implications of this fiscal policy dilemma are not difficult to understand. Elected federal officials are facing growing hostility from an electorate that is demanding more in government services and more in public benefits, at a time when public willingness to pay for those services is decreasing dramatically. Americans want a strong defense, guaranteed security in old age, protection against medical costs, drug abuse enforcement, safe skies, clean air, and free public education. They do not want lax enforcement of antitrust laws, uninsured bank failures, deteriorating interstate highways, unsafe pharmaceuticals, or rampant financial fraud and business abuse of the consuming public. Americans also want lower taxes.

The honest solution to this problem of public demands and public perceptions requires a healthy dose of political courage. Elected public representatives have a duty and an obligation to help shape, as well as react to, public opinion. Education goes hand-in-hand with representation. Unfortunately, on the subject of deficits, political courage has taken a back seat to procedural expediency -- the result is the Gramm-Rudman Balanced Budget Amendment.

Like the constitutional amendment to balance the budget, the political appeal of the Gramm-Rudman plan is obvious. It permits strong public advocacy of action to balance the budget without necessitating public advocacy of extremely unpopular specific spending reductions necessary to accomplish the goal.

It is almost axiomatic that the motive behind any congressional action against deficits can be gauged by the nature of the underlying legislation. If Congress enacts substantive reductions in spending for federal programs through legislation such as reconciliation, the motive is economic and the effort is serious. If Congress enacts procedural legislation -- such as Gramm-Rudman -- the motive is political, and the desire to reduce deficits is subservient to the hope of not offending parochial political constituencies.

It is interesting to note that before Congress adjourned for Christmas, it enacted Gramm-Rudman but failed to enact pending reconciliation legislation. Only time will tell what the ultimate effect of those two actions will be.

If and when the federal budget is ever again balanced, it won't be because of procedural prohibitions against deficits. As long as huge majorities of Americans continue to demand security in old age, government-provided medical care, a strong national defense, and the myriad of other services that have proven immensely popular, elected representatives will ensure those services continue. Circumvention of procedural legislation prohibiting deficits will not only be possible, it will be routine.

Consider the case of the Balanced Budget Constitutional Amendment. If that measure, debated by the Senate in 1983, had become law, the

budget would have had to be balanced last year. Congress would have been required to reduce federal spending by \$212 billion in a single year. At the height of the Reagan drive for spending reductions in 1981 -- the year of press-reported "budget emasculation" -- federal spending was reduced by less than \$40 billion. The public outcry over congressional success in simply reducing the rate of growth in spending for education, school lunch programs, college loans, farm subsidies, pensions, medical care, and other popular programs was so great that the effort could not be duplicated in 1982 -- and has not been duplicated since.

Yet, proponents of the Balanced Budget Amendment would have the American public believe that Congress -- given a constitutional mandate -- would cut spending by \$200 billion in a single year. If defense, Social Security and other pensions, and Medicare are held harmless against reductions in spending, along with net interest payments on the debt (which cannot be arbitrarily reduced), then Congress would have to eliminate all other federal spending to balance the budget. Clearly that is not going to happen.

Even with sizable cutbacks in education, highways, drug enforcement, air traffic control, and all other federal activities, the bulk of a \$200 billion deficit reduction would have to come in large part from national defense and old-age pensions. The savings required would necessitate actual dollar reductions in benefit checks to those receiving old-age benefits, elimination of all cost-of-living adjustments, massive cutbacks in military procurement and readiness, and most likely complete elimination of all federal grants to state and local governments. That, also, is not going to happen.

It's not going to happen because the American public -- contrary to popular belief -- prefers deficits to giving up federal benefits. In late 1981, a Lou Harris poll asked the question explicitly: Would we prefer running a deficit or eliminating the deficit through reduced spending for a number of federal programs? Americans preferred deficits to cutting programs for the elderly, handicapped, and poor (80 to 16 percent); Social Security (75 to 21 percent); health programs (59 to 42 percent); and defense programs (47 to 46 percent). Spending for those five areas alone--plus interest payments on the debt--exceeds federal revenues by approximately \$100 billion.

The priorities of the American public are seldom a mystery to politicians. Those priorities will provide a strong -- more likely irresistible -- motive to circumvent any procedural prohibition against deficits.

The experience of state and local governments having self-imposed legal or constitutional prohibitions against deficits is instructive. Such governments are frequently cited as models demonstrating the workability of a federal prohibition on deficit spending. A close examination of state and local budgeting provides a prescription for circumvention.

Virtually every state government has adopted a system of budgeting that separates operating expenses from capital expenditures. While state operating budgets are generally in balance, state and local borrowing for

capital expenditures has -- over the past twenty years -- been increasing at a rate faster than federal borrowing. State borrowing for capital expenditures is usually accomplished through the issuance of long-term bonds -- as is a good portion of federal borrowing.

This dramatic increase in state and local borrowing has resulted in a series of legislative and statutory caps designed to limit total debt accumulation. State governments facing such limitations on long-term indebtedness have recently begun turning to the use of "special authorities" -- such as turnpike authorities and housing authorities -- which are empowered to finance construction and operations through special bond issues.

The use of special authorities not only circumvents legal prohibitions against deficit financing, it also results in the exclusion of government expenditures from public view. Likewise, the dramatic increase in state sanction of special corporations and "quasi-official" agencies empowered to borrow has further diluted public control of state operations.

The state and local record of evasion of debt and deficit limitations is clearly relevant to the federal situation. The Congress could place all capital expenditures in a budget separate from the operating budget. Estimates of the amount of federal spending that could qualify for capital budgeting range from a low of just over \$20 billion to a high of almost \$150 billion.

It is also logical to expect there would be a proliferation of government-sponsored corporations in reacting to new spending restraints. At present five such federally chartered corporation exist, and all are empowered to borrow from the public through bond issues. Those corporations -- the Student Loan Marketing Association, Federal National Mortgage Association, Farm Credit System, Federal Home Loan Bank System, and the Federal Home Loan Mortgage Corporation -- have accumulated over \$200 billion in outstanding debt.

In addition to private agency creation, Congress could also decide to revise its system of expenditure accounting. The definition of budget outlays is not as cut-and-dried as is commonly supposed. For instance, the federal government receives payments and user-fee receipts from a variety of activities such as airline passenger ticket taxes, leasing of federal lands, and the sale of federal property. These receipts are presently treated as negative budget outlays -- a practice which serves to reduce the total level of federal outlays by over \$35 billion annually. The expanded use of this accounting practice could greatly reduce the reported level of federal outlays.

Perhaps the most detrimental of all approaches to evading limitations on federal spending would be the increase use of federal regulation to force private industry or state and local governments to further federal objectives. Possible regulatory approaches to achieving federal goals could include requirements that employers finance a portion of Medicare payments through employee retirement plans, or that all federally mandated anti-pollution efforts be accomplished through more

stringent--and costly--efforts by private industry.

The temptation to believe that this long list of objections and indictments of procedural prohibitions on deficits is overblown -- or apologetic -- may be great, but they must be taken seriously. If the American public was truly ready to sacrifice existing federal services in exchange for elimination of the deficit, that exchange would have, in fact, already occurred. If Congress possessed the courage to cut federal services or raise taxes to a level sufficient to eliminate deficits -- public opposition to such actions notwithstanding -- that, too, would have already happened.

It hasn't happened. Procedural prohibitions against deficits aren't going to reduce the public demand for services, nor will they give Congress the courage to act against the mandate of the electorate. If Congress had the courage to balance the budget, Gramm-Rudman wouldn't be needed. In the absence of such courage, Gramm-Rudman will simply prove an embarrassment to the nation.

If we are to rationalize our fiscal policy and get our spending house in order, the first step is to cease looking for easy solutions. We must, instead, begin making some hard choices. We must decide if we -- as a nation -- want our government to continue providing medical and retirement benefits at current levels with complete protection against inflation. We must decide if we want to continue providing for national defense at currently planned levels. We must decide if we want adequately maintained roads and bridges, if we want flood protection, drug interdiction, banking regulation, and free education. If we decide the answer to those -- and similar -- questions is "yes," then we must decide if we are willing to pay for those services through increased taxes.

As a nation we have not, as yet, answered these questions. The result is our \$200 billion budget deficit -- and Gramm-Rudman -- both of which shed an enormous amount of light on the question initially posed by this paper: Is a balanced budget politically important?

The constituency for achieving a balanced budget is broad and diverse, but extremely shallow. Those with a vested interest in the myriad of programs supported by federal spending form a far different type of constituency. They are vocal, active, and politically significant. Their very existence is dependent on their ability to maintain federal support for their various programs.

Until the economic consequences of \$200 billion deficits begin to affect the American public through higher interest rates, slower economic growth, and increased inflation and unemployment, it certainly appears that the politics of spending will continue to prevail over the politics of deficit reduction. However, when the economic tide begins to turn, as it surely must, the political tide may turn with a vengeance. When it does, the political importance of a balanced budget -- figuratively if not literally -- will rival the political importance of special-interest spending.

How will we know when that time has come? We will know it because we will see the Congress enacting substantive reductions in federal spending rather than procedural prohibitions on deficits.

IS BALANCING THE BUDGET IMPORTANT POLITICALLY?

by

William H. Gray III

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United States House of Representatives

January 10, 1986

It is tempting to be provocative and answer the question of this panel in the negative. After all, President Reagan carried forty-nine states less than a month after the Treasury reported a Fiscal Year 1984 deficit of \$185 billion which followed a 1983 deficit above \$200 billion. These results hardly suggest that deficits are political poison. This line of argument, however, neglects the immense personal popularity of the President as well as his remarkable success in persuading the public that the deficits are unrelated to the policies of his administration. Most important, it does not distinguish between deficits as an abstraction, with economic effects delayed or little understood, and deficits which carry major economic and political risks for the future.

Most Members of Congress worry a lot about those future economic effects of large deficits and the political repercussions when voters do make the connection. So, for Congress the answer is clearly "yes" -- it is politically important to balance the budget, or at least to have a plan to balance the budget. Except for recessions and wars, the U.S. budget was usually near balance up through about 1969 -- the last year it was balanced. Since then, the American public has seen repeated projections of balanced budgets in the future, which somehow never materialized. The Congress has instituted procedural mechanisms for dealing with the budget which have not produced balanced budgets. The public has heard too often that we can grow our way out of this administration's triple-digit deficits, and has been disappointed. Perhaps it is not surprising that they are perceived to be tired of excuses.

Out of frustration, a newer and harsher mechanism has now been enacted. The Gramm-Rudman plan purporting to balance the budget by 1991 has been passed by Congress and signed by the President and is now law. In the absence of a national consensus including both the Congress and the President of the United States on how to balance the budget, the new mechanism won't work either, but may cause severe damage to our government and our economy. Very few of those who voted for Gramm-Rudman argued that was sound public policy, and the legislation was driven by the inability of the Senate to pass a \$2 trillion debt ceiling without "political cover." The enactment of Gramm-Rudman itself, therefore, provides a compelling case that the politics of the deficit -- or at least the grave dangers of appearing impolitic about the deficit -- are powerful motivations in Congress.

You have probably already heard from the economists that exact balance in the U.S. budget as it now is defined is not necessarily the best rule for smooth functioning of the economy. For example, among policy makers, and possibly among the general public as well, there is increasing understanding of the cyclical nature of the budget. But this understanding has not been

translated into a constituency in Congress that says "balance the structural deficit," or "set the budget deficit level at whatever level produces the best results for the economy."

Furthermore, there is often no public consensus regarding Federal fiscal policy, and given the rhetoric of the White House, it is no wonder. The public likes low taxes, resists specific spending cuts, dislikes deficits, and has been led to believe it can have it all. Paying 80 cents for each dollar of public services, as we do at present, is certainly attractive politically, even if it is not viable economically. The administration bears the major responsibility for this lack of national consensus because it has done nothing to educate the public to the nature of the hard choices that are really needed to balance the budget. Some of the people who favor Gramm-Rudman in spite of its flaws favor it because they expect it to give the President a crash course in basic arithmetic.

My own belief is that balancing the budget on a rigid fixed schedule is neither good economics now nor good politics later. I voted for final passage of the House version of Gramm-Rudman but against the final House-Senate compromise. There are many differences between the two but probably most important is the inflexibility of the Gramm-Rudman deficit targets. The House-passed bill changed the deficit targets, up or down, in accordance with the state of the economy, so that we would have to reduce the deficit faster when growth was rapid and more slowly when growth was slow or negative. The recession escape clause in the compromise is better than the original Senate version but still, in my view, inadequate. It is not automatic but requires either Presidential concurrence or veto-proof majorities. It makes no provision for more rapid deficit reduction when growth is rapid, and it returns to the fixed path a year after the recession, which could give the economy a severe shock while it is still vulnerable.

Clearly, however, a majority of both the House and Senate disagreed. To understand why Gramm-Rudman is now law we need to look more closely at the economic and political circumstances which led to this measure -- one which even its supporters acknowledge to be very bad budget policy. In the words of one Senator, "it's a bad idea whose time has come."

The first thing to be said about the economic and political circumstances of 1985 is that public awareness of enormous deficits and their effects on the economy began to put pressure on Members of Congress. Until about the middle of 1984 we had all of the feel-good effects of large deficits without any of the drawbacks; 1983 and early 1984 is a classic case of the application of Keynesian demand-side fiscal stimulus during recovery. "Crowding out" -- a reduction in investment resulting from deficit-caused high interest rates -- was a hypothesis about the future, not an immediate problem.

By 1985, however, it became clear that we could not escape crowding out. To be sure, it came in a different form from the one most had predicted. Interest rates did not shoot up to a point where housing and business investment went into a nose dive and the recovery was aborted. Foreign capital inflows saved us from that but brought their own horrors: an overvalued dollar and record trade deficits. Instead of losing employment and income in investment goods industries, we lost employment and income in industries affected by foreign trade. The recovery did not end, but it did

stall in mid-1984, and since then growth has not been sufficient to bring unemployment below 7 percent. The problems this has caused in the manufacturing and farm sectors of our economy have been very serious. These problems have generated political pressure to do something about the trade deficit. At the same time, a remarkable number of Members of Congress have come to understand that measures which attack the trade imbalance directly, through quotas for example, are of very limited usefulness as long as the basic imbalance -- huge Federal budget deficits -- persists.

So the effect of the trade deficit was one factor focusing attention on the Federal budget deficit. Another chicken finally came home to roost in 1985 when the President was faced with the necessity of requesting that the debt limit be raised over \$2 trillion. Members of Congress who won their seats deriding \$60 billion deficits and a debt that had not yet passed one trillion dollars were being asked, a short five years later, to pass a \$2 trillion debt limit created by the tax and spending programs many of these same members voted to put in place. Voters and Members noted that it took 192 years and 38 Presidents to accumulate the first \$1 trillion of debt, and just five years and one President to double it.

There is little opportunity for the voting public to gain a sophisticated understanding of the national debt -- for example, of the idea that it is the debt held by the public relative to GNP that is significant rather than the gross public debt level taken by itself. But by any measure, including comparison with previous administrations, the debt accumulation record of the past five years has been excessive, and implies for our nation just what excessive debt accumulation implies for an individual family: growing burdens on the future -- on our children and grandchildren. In other words, the expected public revulsion from a \$2 trillion debt is not a mistake, but a reaction to a real problem caused by the "riverboat gamble" taken in 1981.

While the voting public's attention to the deficit-debt problem was limited in the earlier years of the Reagan administration, the Congress was concerned. In fact, beginning in 1982 Congress took significant action to reduce future deficits. Concerning our latest budget resolution, CBO Director Rudy Penner told the House Budget Committee in October 1985. "most important, the congressional budget resolution for fiscal years 1986-89, although leaving deficits high by historical standards, has changed the budgetary outlook for the better. In contrast to CBO's projections last February of deficits rising to the neighborhood of \$300 billion by 1990, we now project that, if the resolution is fully implemented, Federal deficits will gradually decline from \$210 billion this year to \$120 billion in 1990." Nevertheless, the gradual progress we have made has not been perceptible to the public, and political pressures developed that have stampeded us into new legislation whose faults out number its virtues.

The new legislation is the product of a coalition of three different factions with divergent goals. Some backers of Gramm-Rudman, including at least one of the original authors and many in the administration, believe that the American public wants and needs further drastic shrinkage in the nondefense spending undertaken by the Federal government and, indeed, a radical redefinition of the role of the Federal government in our society. (For perspective, it should be pointed out that such spending has already declined 1 percentage point relative to GNP since 1981, having been cut below

1981 policies by amounts ranging up to \$50 billion.) These proponents appear to believe that Congress will now accept drastic spending cuts -- deeper than those Congress rejected last year -- and phony asset sale savings currently being proposed within the administration, rather than suffer across-the-board cuts in all defense and nondefense programs.

A second faction supporting Gramm-Rudman believes that the prospect of across-the-board cuts will force both the Congress and the President to raise revenues, and perhaps cut Social Security, in order to reduce the deficit. This is the "Grand Compromise" theory. The logic of both these factions eludes me. Virtually all the incentives point to inaction rather than action on the budget. In fact, many of the strongest backers of Gramm-Rudman in the Senate just voted, in effect, to kill a deficit reduction bill that could have gone to the President before Christmas.

A third faction foresees continued deadlock between Congress and the President and assumes, therefore, that the across-the-board cuts will take place, or that extraordinary measures, such as amendment or appeals to the Constitution, will be found to avoid it. This reasoning lay behind the exempting of certain low-income programs and the special treatment given other programs. If you assume sequestration will really happen, rather than assuming it will be an effective forcing mechanism for some other solution, then you want to limit its damaging effects on very high-priority programs.

I have described three different lines of reasoning used by different backers of Gramm-Rudman. My great fear is that the stalemate prediction will prove correct. In fact, Gramm-Rudman has made this outcome more likely. As I said in debate on the final compromise, "Gramm-Rudman damages an orderly budget process by encouraging Congress to avoid hard decisions, secure in the knowledge that a sequestration of funds is to come that will do it instead. That sequestration, then, locks into place today's priorities by hitting all segments of the budget and programs equally, except for the few that have been put off limits. In other words, Congress is abdicating its role in setting budget priorities to respond to our nation's needs. And this is true in defense and domestic programs."

Furthermore, Gramm-Rudman is packed full of other perverse incentives. How do Cabinet secretaries or Congressional committees insulate themselves against future automatic cuts? They'll do everything possible to add some cut insurance to current spending levels. Far from running a tight ship, they'll preserve the fat to protect the bone and muscle. An editorial in the Washington Post put it this way: "the new Gramm-Rudman budget process...has created a new game for everyone to learn, a game called Baselines...The higher you can lift your starting point or Baseline in any year, the less your program has to fear from Gramm-Rudman..." The President is already an expert player in this game. Remember his proposed \$9 billion of defense "savings" this past year -- consistent with a \$30 billion increase in the defense program!

To sum up the politics of the budget under Gramm-Rudman: There is no evidence whatever that President Reagan's understanding of the danger of deficits and the need for revenues has increased. The President will send Congress another politically unrealistic and publicly unacceptable budget next month. We will not get Presidential leadership for a balanced plan to

raise revenues along with spending reductions. Instead, in all probability, we will get stalemate and institutional chaos.

If the process becomes paralyzed, do we really believe the President will stand idly by and accept an automatic 25 percent reduction in our military force structure, a drastic paring back of air traffic control, the decimation of the Coast Guard and Federal Bureau of Investigation? Of course not. Ultimately, the doomsday machine will break under this stress and we'll have to junk it. But perhaps not without a constitutional crisis.

The Congressional budget process developed over the last decade has not done what some feel it should do to reduce the deficit. No process can force a consensus if no consensus exists. But Gramm-Rudman isn't the answer. As the Nobel Laureate James Tobin noted in recent testimony: "It is a tragic irony that this hysterical rush to a final solution should occur just when there is evidence that Congress has made real progress in slowing the growth of Federal debt." The last act in the tragedy will now be played out on the public stage; the ending is unlikely to be what the authors promised and the audience expected. Perhaps then we will find out whether appearing to balance the budget is so important politically that we were justified in ignoring the most fundamental principles of Congressional responsibility and accountability, the precepts of sound economic policy and the dictates of plain common sense.

REPRESENTATIVE CHARLES SCHUMER

January 10, 1986

First I'd like to thank Chairman Gray for asking me to pinch hit for him. As Barber mentioned, he's in South Africa. I am in accord with much of the paper that he has distributed, so rather than repeat its points, I'll try to highlight a few and add some others. Before answering the question, is balancing the budget important politically for Congress, we have to take a step back to a premise we all too often forget. Congress, and I think the House in particular, is an amazing mirror of the views of the American people. I've been in the House five years, and I still marvel at the genius of the Founding Fathers, at how well they constructed a body whose purpose is to be close to the people and actually to mirror the American people's thoughts. That premise leads to the conclusion on the budget issue that Congress generally will follow the desires of the American people as a whole. The fact that we are so mired right now I think indicates that the American people themselves have not reached a consensus as to what is to be done.

There is another point about Congress structurally: it was not created to be a body of great leadership, particularly on complicated, broad-reaching and major issues. Rather, it was supposed to be a check on the President. Congress is very good at following; it is not that good at taking the lead. Those two points, I think, underlie much of what has happened on the budget.

When we ask is balancing the budget politically important to the Congress, we have to ask is it important to the American people? In one sense it has always been important. I am sure that since World War II, if you ask the American people: "are you for a balanced budget?" a vast majority would say "yes." When asked how to balance the budget, they would say, "Well, cut out the waste fraud and abuse." If you live in an urban area you say, "Well, eliminate those agriculture programs." If you live in a rural area you say, "Eliminate the mass transit programs." In the last year or two, however, the American public's approval of balancing the budget may have changed in dimension. In the past, people wanted to cut out fraud and abuse, eliminate somebody else's program. Now if you ask the American people, "Would you be willing to suffer some cuts in your own programs -- programs that actually affect you -- to achieve a balanced budget?" They say yes. That plays back to each and everyone of us in the Congress because when we think of how we're going to vote. In part, at least, we frame the issue in our own minds: "How will my opponent use this against me in the next election? A few years ago, if I voted against a budget-balancing proposal, I could go back to my constituents and say: "I was saving mass transit and revenue sharing, and other programs important to you." That answer does not work so well any more. Why? Why did the American people sort of up their ante in terms of how important it is to balance the budget?

Chairman Gray's paper describes that very well. I could not do as well, so I will just summarize here. He talked about the growing importance of trade issues. People in Congress and in the country at large realize that the kind of protectionist measures bandied about for some part of this Congress really were not half as good as solutions to our trade problems as reducing the budget deficit and lowering the dollar. Whether the dollar will actually go

down if the deficit is reduced is unknown, but most economists and business people seem to believe it.

Second, the old Keynesian approach of spending our way out of a recession sort of lost steam by the end of 1984. Before then, there weren't too many drawbacks to big deficits. Now economic and financial people across the country have reached a consensus like never before that the deficit has to be reduced.

Finally there was the trip wire of a two trillion dollar debt. People who only five years previously had voted to raise the debt ceiling above one trillion dollars were being asked to raise it above two trillion dollars. Even though we know the debt limit legislation is not really the problem, it was a dramatic way that the American people could focus on how deficits had gotten out of hand.

I can't speak for the effect these changes in the American public's view had on the Republican party, but they had a dramatic effect on my party, the Democratic party. Before this change, there were always some Democrats who thought deficit reduction was a top priority, but in the last year I have found it fascinating to watch the mainstream of the Democratic party come to the conclusion that reducing the deficit should be high on our political agenda. Not all Democrats agree, but when you start hearing known liberal Democrats like George Miller and Bruce Morrison -- and I could name a whole bunch -- saying deficit reduction is an important priority, something real has happened. I think the effects of this change will be with us for a while. Many of the newer, younger Democrats believe we must get the "tax, tax, tax, spend, spend, spend" monkey off our backs as a party, before democracy resumes its full flower.

I'll just give you one little anecdote that brought this home to me. I was asked to speak to the NYU Economics Club, right after the Reagan landslide. At New York University, I was expecting the usual liberal thing from the students, and when I entered the room there was no change. I saw people in flannel shirts, lots of beards and long hair. My talk was about banking and the world debt crisis. After my talk, I asked the students to answer some questions for me. I asked, "How many of you voted for Ronald Reagan?" I expected perhaps one-quarter did. Almost three quarters raised their hands. I then asked, "Why?" The students agreed with the Democratic party on social issues. In fact they were afraid of what Ronald Reagan and the Moral Majority would do on those issues. They agreed with the Democratic party on foreign policy issues: they fear global adventurism. However, they were very much against -- or troubled by -- the Democratic party's old notions on economic policies: they thought we threw away too much money; they feel they have a rough economic road ahead; they are paying for a college education, they know houses will be expensive; and that is why they voted for Ronald Reagan.

Well, that was an epiphany of sorts for me, and I suspect that, in different ways, many of my colleagues have experienced the same thing. As a result, as Chairman Gray notes, the House passed a budget this year that was quite different from previous years, although I must say that I agree with the Chairman wholeheartedly on this: we didn't get the credit for it. It was a budget that would have created a deficit of \$121 billion in 1991, rather than

one of \$300 billion. More important, as CBO Director Penner pointed out, it actually changed the slope from rising deficits to falling deficits. That wasn't enough politically. Congressmen felt the need to do more and where the gyro, gear-loose, self-destruct mechanism we call Gramm-Rudman (this Democrat is happy that the media has chosen to leave off the name Hollings from that proposal) came from.

Gramm-Rudman essentially is a mechanism through which Congress talks out of many sides of its mouth. It says to the electorate, "Look. We are going to eliminate the deficit in five years. But do not hold us responsible for the cuts that ensue." Why did it happen? Why was something I consider so ridiculous adopted? Look again to the Constitution and the structure of our government. As I mentioned before, Congress is an accurate mirror of the American people, but it is not great at leading, particularly on these broad, multi-faceted, deeply held kinds of issues. That leadership is the job the Founding Fathers reserved for the President. It was true then; it's even more true today. Yet this President has abdicated leadership on budget issues. He seems to mold his budget rather more as a statement of principle -- "Here is what I would like to see in an ideal world" -- than as a realistic proposal around which to build. As a result he spends most of his time beating up with equal ferocity on Congressional Democrats and Republicans while deficits grow higher. He says he cares about a balanced budget, but his actions show he gives it a much lower priority than the Congress or the public. Just contrast the President's role in tax reform, a similar type of issue: multi-faceted, deeply held, all different groups coming from different places. The President was willing to get into the legislative fray, to compromise so that a tax bill -- as difficult to pass as a budget -- was passed in the House (which is controlled by the Democratic party). If the President would take the same attitude on budget deficits as he has on tax reform, we would see compromise and results instead of Gramm-Rudman.

Faced with the lack of Presidential leadership on the issue and with the public clamoring for a speedy elimination of the deficit, we came up with Gramm-Rudman. The vast majority of Congressmen, certainly the American public, did not know the real implications of Gramm-Rudman when it was voted, and do not know the implications today. They know it is a self-destruct mechanism. They know it is an abdication of responsibility; they may indeed be happy with that fact. But we do not know the actual line-by-line consequences because the entire burden of reducing the deficit via Gramm-Rudman has to come out of a base of only \$270 billion. That is because Gramm-Rudman, which has been criticized because it is an across-the-board-minus-exempted-programs way of doing things is actually worse than that.

In effect, programs that spend their allocated dollars out quickly will bear a far greater proportion of the cuts than slower spending programs. That means, if you take \$185 in cuts out of a \$270 billion base, by the time Gramm-Rudman finishes in 1991, you will have an FBI, an IRS, a Coast Guard that are actually one-third the size they are today. When Congress and the American people realize that, Gramm-Rudman is not going to be implemented. As sure as I am sitting here, it just cannot happen.

What will happen? In my opinion there are only two choices: my Chairman predicts a constitutional crisis. I am not so sure. I think there are two choices. One is a tax increase. That is up to the President. If the

President says publicly -- or even quietly -- he will go along with a tax increase, that could get us out of this box. The other option is simply to do what the woman on "Saturday Night Live" did: say "never mind," and repeal Gramm-Rudman. Before we reach a constitutional crisis, Gramm-Rudman will be repealed. That could put us right back where we started, except that the momentum Gramm-Rudman has created probably will push Congress to act -- and in that sense there may be a silver lining to this awfully sorry cloud.

THE POLITICAL IMPORTANCE OF BUDGET DEFICITS
AND
BALANCING THE FEDERAL BUDGET

by

Senator Jim Sasser

January 10, 1986

In politics, as in life itself, few things are certain. When it comes to the budget, however, one thing is certain and that is that the economic policies pursued by this Administration over the past five years have made annual budget deficits a fact of economic and political life.

Conceptually, it is not the fact that we are spending more than we take in that worries people. It is the steadily widening gap between income and outlay. Indeed the concept of a budget deficit is not new to our government. Since 1940, we have ended 35 fiscal years with a deficit. We have balanced our books only ten times since the beginning of World War II. In the past five years we have more than doubled the national debt from slightly more than \$900 billion to over \$2 trillion. In five short years we have more than doubled what it took us one hundred and ninety-one years to accumulate.

The economic consequences of this debt will be discussed at length during this conference and I will confine my discussion here to its political implications. As a member of the Senate Budget Committee since I arrived in the Senate in 1977, I have listened to the testimony of numerous economists and experts on the budget and financial management. While economists generally are quite adept at projecting with first on the one hand and then on the other, I believe that the divergence of projections which has taken place over the past two or three years has become notably greater than at any time I can remember.

I think it is fair to say that this divergence of opinion -- in economic uncertainty that surrounds us today -- is mainly attributable to the deficit crisis. Across my home State of Tennessee, there is a noticeably growing awareness and apprehension on the part of my constituents with respect to the explosion in debt which we have witnessed over these past five years.

Public opinion polls in every region of the country point to the budget deficit as the number one domestic concern among Americans today. A growing restlessness in Congress has placed the budget process and budget related legislation at the top of the legislative agenda for several years now. This past year, Congress struggled with a budget reconciliation bill which sought to achieve some \$83 billion in savings over the next three years. The Senate failed to act on this bill on the very last day of the session. Thus, from beginning to end, the first session of the 99th Congress dealt with the budget. It never reached a satisfactory agreement. This year, not only can we expect more of the same, but we can also expect that the budget debate will intensify as

continually growing public concern over the deficit exerts pressure on Congress.

The Congressional budget process has been elevated to supracommittee status, and although much maligned, will continue to serve as the focal point for the fiscal state of affairs in Congress this year. Ironically, it was this Administration in 1981 which decided to use the budget process as the vehicle to circumvent the more traditional authorization and appropriation process in order to fast-track its ambitious supply-side program. Since that time, the budget process has gained increasing importance and attention in outlining the spending and taxing policies of our government.

While the process has succeeded in focusing attention on the deficit problem, it has proved incapable of molding a consensus on how to deal with it. The obvious conclusion is that, despite the growing public concern about the deficit, there is no political consensus on how to resolve it.

This may be largely attributed to the fact that we have had a personally and politically popular President who has consistently downplayed the importance of the deficits his policies have created. Indeed, many of us had to wonder whether deficits were really a political problem at all as a supposedly fiscally conservative Administration proposed a string of record high budget deficits year after year and were rewarded with a landslide reelection victory in 1984. Further, in the face of these large budget deficits, we have seen nominal interest rates falling and an economy growing in what can only be considered robust terms.

It is apparent now, though, that the economy is slowing. "Real interest rates", adjusted for inflation, remain historically high, unemployment is fixed on a 7 percent level, and a mounting international trade imbalance, all suggest that a "day of reckoning" is in the offing. And the question which seems to have never been answered with any degree of satisfaction is: who will ultimately pay our bills and when?

It is quite apparent that future generations will be saddled with the tremendous debt that we are accumulating. Last year, we spent \$129 billion on interest payments alone. This represents the fastest growing component of the federal budget. It is growing faster than defense spending and it is growing faster than social spending. This year, we may pay as much as \$140 billion in interest payments on the national debt. These expenditures buy us little more than time. Unless we get our fiscal house in order, we are simply mortgaging the futures of our children and grandchildren. Whether it is a family household or a government, there is a realization that all bills must come due.

We have borrowed our way to a phantom prosperity. But a day of reckoning is inevitable. For the first time since World War I, we have become a debtor nation. It need not have happened, and it need not continue. We should not have to watch our family farmers perplexed and frightened by their own ability to produce. We should not have to witness the steadily rising toll of ruined lives as our manufacturing

sector is destroyed by an overvalued dollar and the wave of imported products it brings into this country.

Against this backdrop of red ink, Congress recently passed the Gramm-Rudman-Hollings balanced budget legislation, which mandates that the federal government adhere to declining deficit targets in each of the next five years until we reach balance by 1991. This measure was borne of political necessity and is the quintessential embodiment of political frustration over the Administration's refusal to acknowledge the deficit problem. With the President set in stone on the economic and political realities of the deficit problem, Gramm-Rudman-Hollings is a chisel, with Congress exercising the hammer, to carve out a realistic and effective solution to a problem which threatens the future of our economy. Gramm-Rudman-Hollings is not pretty. It is a rude, blunt, even primitive device. It is meant to do what has been impossible to date, namely bring fiscal sanity to an Administration whose schizophrenic policies have forced us steadily deeper into debt.

Under Gramm-Rudman-Hollings, the President will be forced to exercise leadership in the fight to get these deficits under control. Congress is not unwilling to make the hard choices and difficult decisions that are necessary, but it must have help from a President who first realizes the problem and then makes a commitment to do something about it. The President is extremely good at putting even the most complicated and complex problems in simple terms. The budget deficit is really a simple problem. We simply must match the income side of the ledger with the outgo to avoid a deficit. And simple common sense dictates that we leave no stone unturned in our quest for realizing budgetary sanity. This requires that we look at all areas of spending, including defense. Where cuts are feasible, they must be made. Common sense also requires that we look at the revenue side of the books. Where loopholes can be closed, they should be closed.

A coordinated attack on the deficit is needed, including the joint leadership of the President and the Congress. Are budget deficits politically important? Yes, but political rhetoric will not solve the problem. Political rhetoric minus legislative action simply will not get the job done.

In the days and months ahead, we in Congress will be presented with the task of devising an economic blueprint for the coming fiscal year and beyond. Both politically and economically it will be important for us to address the concerns and fears of the American people with regard to what the future will bring. Foremost in our economic and budgetary discussions will be how to trim the budget deficit. The prosperity of generations yet unborn will rest on the kind of decisions we make.

POLITICS, PUBLIC OPINION AND BUDGET DEFICITS

by

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January 10, 1986

If there is a single prevailing wisdom about the politics of the deficit, it is that the public's clear and overwhelming desire to reduce deficits is being thwarted by the special interest politics that dominate a disorganized and gutless Congress. This conventional opinion is expressed neatly in one sentence in a recent New Republic endorsement of Gramm-Rudman: "The organized few, who favor one spending program or another, routinely prevail over the unorganized many, who want the deficit reduced."

The expression of this truism is usually followed by exasperation that Congress and politicians cannot do their job, in the face of public impatience; it often, as the New Republic editorial, provides the underlying rationalization for a sweeping structural change, either Gramm-Rudman or a constitutional amendment to balance the budget, to force political action to accommodate the public will.

The problem with this explanation of the politics of the deficit starts with the plain fact that it is wrong. Public opinion surveys of every stripe show public indifference -- at best -- about government deficits; public complacency with the state of the nation and the economy; public consensus that deficit reduction should involve neither a tax increase nor cutbacks in virtually any significant area of government spending. So to address the question of how politics and public opinion figure into deficit reduction requires turning the conventional wisdom around to ask a different question: how, given a political system designed explicitly to prevent it, when the public is in no way united to support it, can sweeping and painful change in the status quo -- i.e., real deficit reduction -- be implemented by Congress and the president? And it requires answering a political paradox: why, given the flaccid state of public opinion, is Congress so obsessed with deficits?

Public Opinion and Budget Deficits

Before we address these questions directly, it is necessary to go over the evidence about the state of public opinion on deficits. A survey of public opinion surveys shows the following:

1. Few Americans see the deficit as our most important problem. In November of 1985, the CBS/New York Times Poll asked Americans which of five areas of concern -- arms control, foreign trade problems, tax reform, the budget deficit and war in Central America -- is the most important right now. The results: arms control led, with 30 percent, followed by the

budget deficit at 28 percent and war in Central America at 15 percent. In other words, barely more than a quarter of the populace singled out deficit reduction as our biggest problem. Earlier in the year, CBS/New York Times asked the open-ended question -- not specifying any areas or problems, "What do you think is the most important problem facing the country?" Eight percent said the deficit, making it a poor fourth.

2. Americans do not want to see taxes increased, or most areas of spending cut, to reduce deficits.

Surveys of every stripe have shown consistent stubborn refusal on the part of the American public to condone a tax increase to reduce deficits. A January ABC/Washington Post poll is typical; 79 percent say taxes should not be increased. A November 1985 CBS/New York Times poll found only 7 percent think raising taxes is the best way to reduce deficits; 57 percent said they would not be willing to pay 10 percent more in taxes to reduce the deficit. There is a broad public acceptance of the notion that reducing spending is the appropriate route to reducing deficits -- 83 percent favor it as an alternative to raising taxes. But consider the results when specific spending areas are broached as avenues to cutting deficits:

- 77 percent think it a bad idea to spend less on Medicare;
- 65 percent think it a bad idea to spend less on farm programs;
- 72 percent think defense spending ought to be either kept the same or increased;
- 50 percent think it a bad idea to cut federal employee pay;
- 94 percent think it a bad idea to cut Social Security benefits;
- 81 percent disapprove of cuts in veterans' benefits;
- 83 percent disapprove of cuts in Medicaid;
- 50 percent think it a good idea to cut spending for Amtrak, a rare exception to the general pattern.

These results are taken from various CBS/New York Times and ABC/Washington Post surveys taken early last year. The results have not changed measurably, nor are they much different for other areas of government spending, save foreign aid and welfare (and by welfare, Americans do not mean poverty programs; 59 percent in a Los Angeles Times survey think the federal government should spend more on poverty programs.)

There is one clear explanation for the apparent inconsistency between the general opinion that spending should be cut and the specific views against cutting nearly every program: three-fourths of Americans also consistently express the view that there is a lot of waste in the federal budget. Jack Anderson and Peter Grace have reinforced the public sense that cutting spending and deficits means cutting waste, not cutting programs.

3. The public is contented with the state of the nation, convinced that the country is not in serious trouble.

Over the past decade or so, Yankelovich surveys for Time Magazine have regularly asked respondents how they think things are going in the

country these days, and whether they think the problems we face are no worse than at any other time in recent years -- or whether the country is in deep and serious trouble. At the height of congressional-presidential conflict over the budget last July, 69 percent said they thought the country was going well, and 58 percent said the problems we face are no worse than other times -- near the high for the past eleven years! At the same time, the public registered very high levels of consumer confidence, indicating belief by people that they will be better off in the next five years, and that things will be bright over the next six months and year. In the two major indices of consumer sentiment, the University of Michigan and the Conference Board, the numbers were respectively, 94 percent and 92 percent in July, up considerably from a couple of years earlier, and stable over the past year.

Why the Fuss? The Politics of Congress

Any pragmatic and realistic look at the overwhelming evidence in public opinion surveys thus puts the lie to the notion that the public is at the barricades, demanding action to cut the deficit. Yet it is clear that Congress is gripped by deficit reduction, obsessed to the point of collective physical and psychic pain as its members agonize over ways to bring deficits down. The Washington Post's Helen Dewar described it well in characterizing 1985 in Congress: "From start to finish it was a Congress obsessed -- bedevilled by deficits that seemed to hover around \$200 billion a year no matter what was done to cut them and haunted by fear of how this debt could ultimately affect the economy." Congress was so motivated, in the end, that it voted overwhelmingly to cede its most cherished constitutional prerogatives in order to reach a solution -- a solution crafted in part to generate the kind of crisis atmosphere that would exist if the public truly were up in arms. Why, given the public, is Congress so upset? There are several reasons:

1. The deficit has become a metaphor for governing.

Editorials, television talk show commentators and politicians alike have portrayed deficit reduction as the test for government and leadership. Failure means allowing, a la The New Republic, the special interests to triumph over good government. This kind of collective judgment usually leaves individual members impervious; indeed, they exploit the broad sentiment, each individually criticizing their collective institution for its gutless in-action. But today, the collective sense of responsibility has more meaning and coherence -- especially to the Republican Senate.

Collective responsibility means more when a party majority is slender, and therefore at stake in the next election. It also has more tangible meaning when a majority is relatively new for a party, before its members have had time to find skillful ways to deflect responsibility. And a party majority, with its President in the White House and with a split Congress, feels a particular sense of responsibility to govern well.

All of these conditions characterize the Senate Republicans. A margin of three leaves their majority highly vulnerable in November -- and means that the 31 Republican senators not up for election have almost

as much at stake as their 22 colleagues who are. For the Republicans, the majority they have held for six years was their first majority in a quarter century; only two GOP senators, Thurmond and Goldwater, experienced majority status in the Senate before 1981 (Thurmond because he was a Democrat most of his career.) And in 1986, Senate Republicans face a country which holds their party accountable, but which will be unable to judge directly either President Reagan, who won't be running, or House Republicans, who readily proclaim their minority status. Senate Republicans feel that they -- and nobody else -- will be held accountable for how government has done its job; the deficit has become the issue of accountability.

The attitude of Senate Republicans affects the approach of the majority House Democrats as well. If the Senate Republicans do take the issue of the deficit seriously, and do act collectively responsible, then House Democrats are vulnerable to the charge that it is their fault. If that charge is reinforced by a popular and persuasive President and spread through tens of millions of dollars of Republican Party-financed campaign television commercials, it could prove deeply damaging. Thus, House Democrats also feel considerable collective pressure to respond to Senate initiatives.

2. Members of Congress believe that deficits are destructive. Though it goes against the grain of American culture to believe it, Members of Congress are patriotic Americans who feel strongly about doing what is right for the country. There is probably no area in which there is a broader consensus in Congress, from liberal Democrats to conservative Republicans, than the need for serious action on the deficit. In the cloakrooms and the corridors, the issue dominates conversation, and the sentiment expressed is real. Some are more concerned about the effect of deficits on interest rates and the dollar; some about the pressure on domestic programs; some about the impact on defense; others are more worried about future inflation or spiraling interest costs. But no more than a handful of lawmakers believe that the deficits are minor problems overshadowed by others.

3. Members believe their future as an institution, and their role as lawmakers, is threatened. The deficit problem is, in no small part, a structural one. Currently, 85 percent of the federal budget consists of three basic elements: defense; direct benefit payments to individuals; and interest on the debt. All are growing rapidly, none faster than interest on the debt. Continuing large deficits mean even faster growth in interest payments, and, if inflation results, in accelerated growth in defense and entitlements. Everything else in government -- so-called discretionary domestic spending -- is thus down to 15 percent of the budget and shrinking. That "everything else" is the life's blood of Congress, the money available by and large to solve social problems. A good deal of it, of course, is not truly discretionary, such as spending for the FBI, air traffic control or national parks. But if there is no leeway to respond to growing problems or unanticipated events, Congress, and its members, will have to reanalyze their basic role -- even as they contest vigorously and desperately for the slices of the pie that remain. With the trend in tax policy making tax preferences a less feasible route to

shaping social policy, combined with deregulation, Congress and Congressmen have a deep interest in bringing the deficit under control, as a prerequisite to reordering budget priorities.

4. Members of Congress are spurred by the politics of realignment and the politics of 1986.

We may not be in the midst of a historic realignment of political forces in this country. But there is a palpable and widespread sense, among pundits politicians and psephologists, that the enduring party majority is up for grabs. Naturally, this impression makes both parties nervous -- the Democrats, because their long-time hegemony is eroding and might be reversed, the Republicans, because this once-in-a-lifetime opportunity, if blown, may not come their way again. The results of the last three elections have been inconclusive (the big GOP victory in 1980 was followed by a significant loss in 1982; Reagan's overwhelming landslide reelection victory in 1984 was accompanied by trivial gains in the House and a loss of seats in the Senate.) 1986 may be the rubber match, either solidifying the Republican hold on the crucial group of young voters, or throwing them back into contest.

Added to the bipartisan nervousness is the fact that 1986 is a sixth year election, the first "pure" one since 1958. The sixth year, the second mid-term election of a two-term President, always results in a loss of seats for the President's party, and usually results in a heavy loss in both houses of Congress. If 1986 resembles 1958 -- the second mid-term of an elderly, popular Republican President who won reelection by a landslide -- it will be a massacre for the Republicans. Back then, despite Eisenhower's continuing popularity, a deep recession spurred GOP losses of 47 seats in the House of Representatives and 15 seats in the Senate.

Today's Republicans, especially in the Senate, are aware of history -- and believe that the key to the economy next year (at least the part that is within their control) is the budget deficit. They are especially fearful that failure to cope with the deficits will lead to a reaction by the financial community, the Fed and the international community of the worst sort, at the worst possible time. If these groups become convinced that the deficit problem will not be solved and will spiral out of control, the reaction, to protect against the inflation that would likely result, would be higher interest rates, curtailed investment, tighter money supply and a withdrawal of foreign deposits -- all meaning economic headaches as the election season begins. Gramm-Rudman was explicitly designed to assuage the financial community that the problem would not be allowed to get out of hand, for these reasons.

For Democrats, deficit woes do not signal good news 'a la 1958. The Democratic Party's imperilled status is underscored by its declining image in the public as a force able to cope with major national problems. Conceivably, the Democratic Party might be blamed for economic problems in 1986; at the least, the charge of Democratic complicity would be received by a public predisposed to believe it. Thus, there was near-panic among Democrats when Gramm-Rudman arose in the Republican Senate, and loomed as a vote by the Republicans against the deficit -- leaving them, if they opposed Gramm-Rudman, as voting for the deficit.

In other words, the electoral politics of 1986 impel the Republicans to do something now about the deficit, and to convince the outside world that they have acted, and in turn impel the Democrats to avoid being charged with culpability, by going along with a deficit reduction plan.

The American Political System and Budget Deficits

The Founding Fathers designed a political system to make government action difficult; the more seeping or painful the change in the status quo, the more difficult for it to take effect. Let us start with the premise that real deficit reduction requires painful, sweeping change in the status quo, not simply painless removal of waste, fraud and abuse along with elimination of programs that benefit only "special interest," not people like you and me. It is inherent in the American political system that such actions will be nearly impossible to implement without a clear consensus in the public on the need for painful action -- and on its urgency. That consensus, as the first section of this paper makes abundantly clear, is not present.

Neither is the obvious substitute, a clear consensus among governmental elites over the need for urgent action. President Reagan's reelection campaign, which set out the issues that tend to frame the governmental agenda, was based on the theme, "It's morning in America." This theme was obviously embraced by the public, and is reflected in the soaring levels of consumer confidence shown in the polls. It is not a theme that puts painful deficit reduction in a place of prominence among presidential priorities. The president, of course, has set out other priorities that relate to deficits: absolutely no tax increase of any variety, real growth in defense of 3 percent, no adjustment in social security benefits or COLAS, deficit reduction to come almost exclusively from discretionary domestic spending, as defined above.

The House of Representatives has also set down clear institutional priorities: no change in social security whatsoever, no tax increase (especially one proposed by the House), limited cutbacks in the growth of other domestic programs, limit the growth of defense. The Senate has led both the president and the House in deficit reduction initiatives and in proposing broad budget and tax changes -- but its priorities have not been clear institutional expressions, but barebones majorities or pluralities.

Given these painful realities, it is not surprising that frustrated legislators who want deeply to take decisive action on deficits would turn to structural reform. There is a long tradition in America of tinkering with institutional machinery, inside Congress and more broadly in the political process. A series of "good government" reforms in the decades around the turn of the century dramatically altered electoral politics, voting procedures and the role of political parties. Constitutional amendments have provided direct election of senators, limited presidents to two terms, and expanded the franchise several times. The power of the purse has been changed regularly in Congress, including creation of Appropriations Committees in the House and Senate after the Civil War; the Holman Rule in 1876; the creation of the

executive budget, the Bureau of the Budget and the General Accounting Office in 1921; a federal legislative budget in 1946; and the Budget and Impoundment Control Act in 1974.

Gramm-Rudman is the most recent institutional response to conflicting deficit pressures. It comes from senators who want to force a consensus on the primacy of the deficit problem and on policy priorities among political actors where none exists. It is designed to force a crisis in the budget process to force action, to substitute for the crisis that should exist in the minds of the American public. And it was crafted, in the words of one of its original architects, "to force the president to accept a tax increase."

Will it work? The history of structural reform in America suggests skepticism, both because of the "Iron Law of Unintended Consequences" and the inherent limitations of sweeping structural solutions to deeply political problems. We have seen laws mandating balanced budgets before, such as the Byrd Amendment, that have had no perceptible effect. It is clear, however, that Gramm-Rudman will have a real impact, and not entirely negative. First, it is likely to strip away the fiction that deficit reduction is easy and painless to all of us who don't profit from fraud and waste or belong to "special interests." Anything that will convince the public that real deficit reduction requires making painful choices among cherished priorities is positive; the more people believe that reducing deficits can be done without pain, the less they will be willing to incur pain.

Second, at least in the next year, Gramm-Rudman does focus on choices that have been made among and between the big-ticket items in the budget -- defense vs. taxes, social programs vs. social security, etc. If these alternatives become the frame of reference, political actors will find it easier to discuss cutbacks or slowdowns. Currently, we address individual issues individually; no one is willing to cut the

deficit on the backs of the elderly, or to vote against social security. But if the issue is framed as a choice -- reduce COLAS or see defense readiness cut deeply or legal services and infant feeding totally eliminated -- the political ramifications change.

But I do not expect Gramm-Rudman to achieve its goals, or to solve the deficit dilemma. A structural reform of this sort will not enable Congress to impose draconian and widely unpopular budget changes on a public that doesn't want them or think them necessary. Congress will change the law before its members will commit political suicide. We will not see the wholesale elimination of domestic government just because Gramm-Rudman theoretically forces it. Gramm-Rudman does not make it any easier to make excruciating choices for Congress or the president. The reconciliation debacle at the end of the first session of the 99th Congress -- after the enactment of Gramm-Rudman -- underscores this point emphatically.

Of course, we must add to these misgivings the tenuous constitutionality of Gramm-Rudman and the potentially disastrous long-range effects of rigid requirements upon a fluid economy. In all,

Gramm-Rudman is a riverboat gamble greater than the 1981 tax cuts, one in which the realistic potential payoffs are far exceeded by the potential losses.

If Gramm-Rudman, or any structural change, is not the answer, what is? Sadly, there is no easy or simple answer. The nature of the problem requires either or both of two developments: first, a much greater sense of urgency and willingness to accept action on the part of the public; second, a greater degree of unity on the scope and direction of the action on the part of political actors. One good place to start is Jim Jones' suggestion for an economic summit -- not an empty gesture or closed meeting among a handful of politicians, but a full-blown gathering of heavyweights from politics, business, finance and academia who might forge an alliance on the shape of a deficit reduction compromise (say, for example, a two-year freeze on the budget and an adequate tax increase) and at the same time publicize the problem to increase public awareness. It would also be useful to find other ways to educate the public about the insidious harm done to the economy by deficits, and the danger of an explosion ahead; a well-done and well-advertised public television special on the deficit cancer could do a great deal to educate opinion leaders in America.

These are modest suggestions to resolve an immodest problem. But we will only be fooling ourselves if we expect a simple structural adjustment, albeit a sweeping one, to overcome the inherent safeguards of the American political system. It would be even worse to wait for economic events to force the sense of crisis in the public that will precipitate political change.

IS BALANCING THE BUDGET IMPORTANT POLITICALLY?

Discussion

Panelists:

Howard Fineman, NewsweekKevin Phillips, Writer and Television CommentatorJune Cross, Producer, MacNeil/Lehrer Newshour

HOWARD FINEMAN: Let me start out with the New Republic editors, since Norman mentioned them. As it happens, I consort with them occasionally, and I know a few of them. It just occurred to me as I was sitting here, several of them probably ride back and forth to work on a subway system that costs billions of dollars in Federal money. Magazines enjoy tax benefits and postal subsidies. Some of the editors are probably still paying off low-interest student loans. They bought their home computers on which they write denunciations of special interests with the assistance of a tax break for the purchase of such things until the end of last year.

What I can't stand about all this is something I see as a major impediment to making any progress: the holier-than-thou attitude that everybody seems to be able to muster on the subject of the budget. That includes calling it a crisis. I think the sense of crisis out in the country varies in inverse proportion to the distance you get from the Dirksen Senate Office Building. I take as my touchstone people that I met in New Hampshire in January and February of 1984, people who managed to make all of us in the political reporting business look ridiculous when they knocked the props out from under Walter Mondale and chose Gary Hart in the New Hampshire primary. I try to keep in touch with some of those people, and I can tell you that while they have a sense of unease that is kind of hard to quantify in polling numbers, they will not sit around the dinner table talking about the sequestration order when it comes. They may be thinking of sequestering their kid, but not the budget.

We need to look realistically. I would cite one of the great political theorists of our day, John Mitchell, who said when the Nixon Administration came in, "Watch what we do, not what we say." That can be applied to Congress and to the country as a whole. Perhaps what we have done with the money we have borrowed is purchase a period of what you might call restoration. This has been valuable. There has been a social transformation in this country. The elderly are now very much the responsibility of the Federal government more than they were even ten or fifteen years ago. In more than 50 percent of the families both husband and wife work.

At the same time, I think Professor Modigliani is also correct that we have to look at the total Federal debt as a percentage of our GNP and our ability to pay it off. At some point down the road we will enter another period of recession. We do not know what catastrophes or other events may await us, and we have now built the debt as a percentage of

GNP back up to the level it was in the mid-fifties. That's something we all have to think about.

So I think we are approaching a crossroads, and whenever we approach a crossroads, we seem to end up in a constitutional crisis. I do not think there is a consensus in the country on what to do in the period that follows the corrective or restorative one that Newt Gingrich was talking about. We do not precisely know where to go, which is one reason why control of the Congress has been divided for six years now, for only the second time in this century. We have a split-level realigned system in which the presidency is virtually a sinecure of the Republican party, and much of the rest of the system is in the hands of the Democrats. I think that reflects confusion and division in the country on what to do. We have to face up to the choices, and we are not yet doing it.

Finally, taking my cue from Congressman Rhodes, who last night complained that the reporters were not being tough enough on the Members of Congress, I thought that I would ask the Members of Congress here about a couple of programs they might be willing to put on the table in the effort to come to grips with this horrible problem of the deficit. I thought I would ask Senator Sasser, for example, about user fees on the Ohio River for barges and about the Tennessee Tom Bigbee waterway. I might ask Congressman Schumer about revenue sharing, which I gather matters greatly to your mayor. I would ask Senator Nancy Kassebaum about the farm programs. How much can we really afford? I would like each of the three of you to speak specifically on those programs and say how you have stood the test of leadership in controlling those costs. Take it away.

KEVIN PHILLIPS: I would like to bring things down towards the nitty gritty politics involved. That really is the be-all and end-all here. I would disagree with some of the poll analyses we have seen. I think it is pretty clear that the deficit has moved up to the number one issue category. The polls right after the summit were somewhat misleading because arms control mushroomed briefly, but I think the deficit is there. I do, however, agree with those who say that the public's view of the deficit as the number one priority is not accompanied by any desire to cut very many programs. The polls support that proposition. There is some increasing evidence, although thin, that the public does recognize there probably is a need for a tax increase. That is crawling up, but it is a heartening development, in my opinion, because I think that is one of the directions we will have to go.

What I would like to do is look very briefly at the politics of how it happened. Who did the deficit deed, as it were? There are three alternative theories, to oversimplify here a little bit. There is the "Paul Volcker is the bad guy who really did it" theory, which I think is simplification of what my supply-side friends would say. There is the theory that "the Democrats did it because they never met a program they did not like and they cannot bear to cut the legacy of FDR and Truman and Johnson and so forth." And there is the theory that "essentially it was the Reagan Administration that did it with its tax cuts and defense build up."

There is probably a little truth to all of them, which is why we will not have much of a debate about it. But as one who was involved sometime back in Republican strategy and as one who analyzes politics, I unfortunately must say it is principally due to the tax cuts and the defense buildup. This is why I think it puts the Republican party so much on the defensive.

Having said that, I think one reason why it did not gather a head of steam in 1984 when it should have, when we should have had one hell of a debate on all this, is that the Democrats -- with their rare perception of national political currents -- nominated for the first time in recent history the defeated Vice President of the Administration thrown out of office four years earlier. The President in question happened to be the first man in history who had his job approval drop below the prime rate. Well, under these circumstances, you did not have too terrific a debate. As a result the 49-State sweep probably misleads us. I do not think these issues were seriously debated. I think that the Administration has over interpreted the 1984 election, which I will come back to in a minute.

One of the reasons why the deficit issue mushroomed in a big way in 1985 was that you had all these areas whose suffering was pushed aside by the feel-good aura of Reaganomics and the election campaign: the farm sector, the business sector with the overvalued dollar which they linked to the budget deficit, the trade imbalance and the industries in jeopardy there, and of course the ongoing concerns of the financial markets. All of these accumulated in 1985, especially perhaps the trade and dollar issue, to push a lot of people into a higher level of concern. Therefore, the issue did begin to mushroom in the polls, and we got Gramm-Rudman-Hollings. We got Gramm-Rudman-Hollings because the elites are more concerned with this issue than the public -- rightly so since they understand the ramifications.

So here we are with Gramm-Rudman-Hollings, and what is it? What are the politics of Gramm-Rudman-Hollings? What are they going to produce? Can it work? My evaluation of Gramm-Rudman-Hollings is essentially this. The process is going to be the surrogate for Reaganomics, for looking at the efficacy of an economic approach which was not debated in the 1984 election. I think that is why the Democrats supported it; they may not have understood it. Teddy Kennedy was correct, as correct as he was to withdraw from the Presidential race, when he voted for Gramm-Rudman-Hollings. What you have done is set up an end to the feel-good era of Reaganomics, an end to the era when you can have all the balls in the air at one time: the legacy of the tax cuts, the defense buildup, anti-program rhetoric without the need to actually cut anything, (because not too much really ever did get cut).

It will be the end of what Mark Shields calls "ouchless politics." From a Republican standpoint, I think what they have gotten themselves in for now is a crossfire in three dimensions: the interaction between domestic program cuts or the lack thereof; between the defense buildup or the reduction thereof; and between a tax increase and everything else. Obviously this is a set of choices the Reagan Administration does not want. That is why the President is apparently doing his best, using constitutional theory to sap the logic and the thrust of the sequestering

mechanism now. This is going to be a very tricky time for the Administration and for the Republican party. I think Gramm-Rudman-Hollings is a mechanism for constituency alienation. People do realize that the deficit needs to be cut, but as the polls Norm cited so correctly show, they do not really want very many programs cut. You can cut welfare, but welfare has been cut. There is just a fundamental problem here.

Now I would like to turn briefly to what I think is a misestimate on the part of the Administration about the whole issue: that you can cut the deficit on the domestic spending side alone. This shows the extent to which the Administration thinks you can return to a kind of free market era that perhaps never existed. You can let the dollar find its own valuation, you can cut domestic programs all over the place, you can strip the tax code of its preferences and make economic decisions market place decisions.

I do not think the public voted for that in 1984, and I think the Administration faces a problem in its basic blueprint of trying to roll back the public sector too far. They will have to settle, in the end, for some form of tax increase. The whole debate is going to get to that -- a tax increase will be 30-40 percent of the deficit reduction. Logic will support what seems to be developing in Washington, which is some form of consumption tax. That is appealing because of the impact it can have on deficits and on easing tax reform and because it moves to a border-neutral tax system, which can help with the trade imbalance. I think that the political resolution of the deficit crisis will catalyze a movement towards a tax increase, and we have to hope it is the right tax increase.

JUNE CROSS: I am going to be even a little bit more controversial than I think Kevin was. I have not been covering the intricacies of Gramm-Rudman-Hollings these last couple of months. I have been out in the country. And I have to admit if I answer the question, "Is balancing the budget a politically important task?" I will have to answer cynically, "No, I do not think it is." I think looking like we are doing something about balancing the budget is important politically, and that is what has been going on in Washington for the last three months or so.

Perhaps the public does not really understand what the deficit is or what balancing the budget means, but it has just really been in the last year and a half that anybody has figured out that the deficit can mean a lost job. In the last year and a half you have seen company presidents and bankers begin to get very worried about the fact that they are having to move operations abroad. Farmers worry about the fact that they are losing some export markets. There really was not a kind of public grass roots movement, as you have heard Norm and the others talk about.

This deficit is really important, but it is hard to get people focused on the need to really get a handle on the deficit, especially in this day and age where everybody has a least three credit cards and is charged up to the hilt. I think one of the reasons is that the debate in Washington has been really focused on other things. Reagan campaigned,

in part, on the deficit and balancing the budget in 1980, but in his first year in office, his first priority was getting a strong defense. The second year in office, it was getting a tax cut. His third year in office he focused on the New Federalism.

I agree with Newt Gingrich that that debate is still ongoing. People are trying to figure out what role the Federal government should play; what role States should play. That argument was never settled in 1983. 1984 was an election year. The issue was still unsettled. As 1985 began, there was still no agreement on how to put this budget together, so we got a smokescreen called Gramm-Rudman-Hollings, which is supposed to force people to sit down, compromise, and reach some kind of consensus.

In a way, it looks like we have come full circle. I think Congress has codified the disagreements that they had over the last two years; and having codified them, they are going to try to compromise the disagreements away. People are already saying it will not work. I guess I have to be fairly cynical: if it will not work, why was it passed in the first place? Are we really going to get some other answer out of this? Is there going to be some kind of final solution? I do not know. I would like to hear from the Representatives here, just where they see areas for consensus.

If Gramm-Rudman-Hollings really is a vehicle to force a national consensus, is there some solution somewhere that gets us away from taxes? I think the one thing that has come through is that the public really does not want to pay any taxes. As a member of the baby boom generation, I guess I can say that I have not talked to anybody under forty who believes social security is going to survive until I reach retirement. When I look around the country, it seems that the issues are not really defense, taxes, or social security; the issues are the young versus the old and the haves versus the have nots. Who is going to have those benefits when the day is done and this race is over?

BARBER CONABLE: Thank you very much, June. I would like to tell you, as a member of the Social Security Reform Commission, that I suspect your social security benefits are going to be there. Whether they will be worth anything or not is another question. That will not so much be a question of the internal management of the social security system as a question of whether at that point we will have put ourselves in a position where in order to make a staggering debt meaningless, we have had to make money meaningless.

I think we have demonstrated the frustration that all members of Congress feel over this issue. I think we have demonstrated that the same arguments are made over and over again, that there is never going to be a time when we are going to be able to sit back and say, "There, we've settled our fiscal problem, now let's move on to something else." Fiscal problems are always going to be with us, and they are always going to be at the center of many of our political issues.

SENATOR JAMES SASSER: June Cross asked if there were any consensus areas in which we in the Congress could deal with the problem of the deficit. I think yes, there are consensus areas. In my judgment a majority of both Houses would agree that there are areas of defense spending in which we can agree on cuts. My own view is that perhaps we could lop \$20 or \$30 off defense without seriously impairing the defense buildup. I frankly think that the DOD, with foresight, has put at least that much air in their figures.

There are also some areas in domestic spending on which you would find agreement. Finally, I think if the Congress had been able to work its will in a bipartisan way, you would have seen additional revenue increases enacted last year. I think we have demonstrated in the Senate that we can approach the problem of the budget deficit in a bipartisan fashion and reach some common consensus. I supported, for example, the freeze proposal put forward by Senators Kassebaum, Grassley, and Biden. We called it the KGB proposal. I think it is unfortunate that that KGB proposal did not pass in 1984. We would certainly be in a better position now to deal with the deficit if we had that in place.

At the risk of sounding like a complainer and whiner and pointing the finger somewhere else, and I do think Congress has some responsibility for the deficit, but in the last year or two the chief impediment to trying to deal with the problem of the deficit has been the President of the United States. I think the President believes two things very deeply and very profoundly: one, we must continue the largest defense buildup that we have had since the Korean war -- larger even than the one going into Viet Nam and during Viet Nam; and two, he probably feels even more fervently that there shall be no tax increase.

I sat in the cabinet room -- I have only been there once in this Administration; I am delighted to be invited -- but I saw the President look at one of my colleagues and say, "Damn it. There will be no tax increase." I think Nancy [Kassebaum] was there that day. This was a moderate Republican, a wise Senator in my judgment, putting forward what he thought was a consensus to try to deal with the problem.

DR. NORMAN ORNSTEIN: Jim, was that before or after the 1982, 1983, and 1984 tax increases?

SEN. JAMES SASSER: This was after all three of them.

JUNE CROSS: I had not heard that there were many people interested in or that there was a consensus to cut \$20 or \$30 billion from defense.

SEN. NANCY KASSEBAUM: I guess I feel some responsibility to answer the question on farm problems, but it could take about half an hour to explain my rationale. One important point that has been raised here is we have started down a different path. I think the country did want this. I have been a strong supporter of the New Federalist type of

approach whenever that may come to be; what is happening is a very exciting shift in initiatives to State government. As State legislators are picking up on the initiatives and the direction from the sluggishness of Washington we see a profound change beginning. It will be aided and abetted by our approach to the budget.

Regarding the farm problem: Yes, we are spending too much; the estimate of some \$50 billion over three years for the farm bill is a low estimate. We do have an enormous farm problem. The ripple effect from that unease in farm country affects our ability to do much else in domestic and foreign policy because you can lose a lot of support quickly. In States where Republican Senators have separated themselves from the Administration -- as Senator Grassley has, gaining enormous popularity in Iowa -- it is because of the farm problem. My solution is easy to criticize, and I do not know that I have any better solution than anyone else. I felt that the farm bill last year was probably the best we could do, but it is too expensive. The worst thing is, basically it is the same thing warmed over, and I do not think it addresses the underlying problem of production. I am one who has supported mandatory production control in some better form than was offered on the floor of the Senate. We were writing an enormously complicated piece of farm legislation on the floor of the Senate at the last minute, with very few of us knowing really what was in it. That is not a particularly good answer.

HOWARD FINEMAN: I think Gramm-Rudman-Hollings is largely an expression of defensive politics. We have all more or less agreed that we are at the beginning of a new period in our attitude toward government. No one knows precisely how to solve these budget problems by balancing priorities, so Gramm-Rudman-Hollings is a defensive maneuver. However, it will not work. If people think that Gramm-Rudman-Hollings is going to prevent incumbents from losing if the economic indicators start going down, I think they are crazy.

On the other hand, if the economic numbers stay fairly constant, then it will not really have made that much difference. I think it will do two things. Number one, when the President sends up his budget this time, it will be laughed at a little less quickly and with a little less effect than the last time around. People will not just throw it away. It will get at least some measure of a serious look. Second, we ought to keep in mind the timetable. According to the Gramm-Rudman-Hollings timetable, the big argument over sequestration and meeting the targets will come in the fall of this year just before the 1986 election. This probably will heighten the stakes all the more for Republicans who are up, especially those in the Senate who have taken the lead on the deficit. They are raising themselves up higher, perhaps only to fall further if they do not come up with something.

One other point -- baby boomers have been mentioned a lot, and as one of them, I thought I would make a comment on that subject. We were raised in an era of affluence. Everything was bigger, better, more. There have been many stories lately about baby boomers settling for smaller, worse, and less. If that really begins to become the attitude

and the pervasive economic reality then somebody is going to pay, and it is going to be incumbents of all political stripes. Right now incumbents are still doing fairly well. If economic reality flips over, then you are going to see a massive, massive shift.

BARBER CONABLE: I think it is always possible that the great negative traditions of American politics will be enhanced.

DR. NORMAN ORNSTEIN: Curiously enough, there is, I think, an overwhelming consensus in Congress -- and has been for three years -- over what to do about the deficit. Everybody is waiting now, I think, for the time when the Grand Compromise occurs. That Grand Compromise is an overall budget freeze on everything we can get, including freezing the COLAs. It will not be freezing all the programs, of course, and the defense freeze will be zero real growth. The spending freeze would be supplemented with some form of broad-based tax increase in an amount roughly equivalent to what you save by freezing the budget.

People have been waiting for this for more than two years. They are waiting for the President to change his priorities. His priority is to cut as much of domestic government out of our lives as he possibly can, and when he is done with that, then maybe he will turn to deficits. He has been using deficits. I believe a lot of people thought, "Well, 1985, right after the election, this will be the last big push to get rid of a lot of programs that do not mean much in budget terms, whether legal services or endowments for the arts and humanities. If he cannot make it now, he will abandon that notion.

One problem with Gramm-Rudman-Hollings is that it gives him another lease on life, another opportunity to try and squeeze out these domestic programs and postpone the day when he will change his priority to reducing the deficit. When he does, which I think will come right after the 1986 election, we are going to see a grand coalition and a compromise.

BARBER CONABLE: That is an interesting point, Norm. I do believe that there are two ways in which policy occurs in our system. One is when there is strong Presidential leadership in the direction of change, and the other is when there is a crisis. But of course, when the crisis occurs, it is very difficult to justify taking steps looking toward the kind of austerity which sometimes is procyclical, and therefore, enhances the crisis.

DR. FRANCO MODIGLIANI: You say the polls show the public is not very concerned. That is understandable. A deficit is always good for those living under it. It is always easier to send the bill to the future. So the question is, why have we not always had deficits? The answer is, because of ethics. Remember that President Kennedy could not get a tax cut because of fears about the deficit. Why was it different then?

Isn't it your duty to wake up the public? Why did we go for years with opposition to deficits? What has changed?

HOWARD FINEMAN: I think that in an era when people open their mail and find an unsolicited credit card, borrowing has become a way of life, not only for government, but for individuals. Look at the stories that we read every day about international debt, private debt, consumer debt, corporate debt. There was a period, especially in the inflationary period of the last decade, Professor, when people concluded that the proper mode of behavior was to take Benjamin Franklin and pitch him back into the Schuylkill River. "To hell with 'never a borrower or a lender be'; to hell with 'a penny saved is a penny earned.' Borrow as much as you can. Get in hock as much as you can." In an inflationary era that was how we were all told to behave. I think the attitude of the public was certainly deeply changed by that phenomenon, although maybe not permanently.

REP. CHARLES SCHUMER: I am not as pessimistic as you, Professor, or as many of the panelists. First of all, I think the public sees the deficit as more of a problem. I differ with Dr. Ornstein; I think people are now willing to give up something. They do not accept the elimination of a program near and dear to them, but at least regarding revenue sharing, mass transit, or community development block grants, the constituent groups say, "OK, we will take a 10 percent cut; just don't make it a 20 or 25 percent cut."

This is worlds away from what they were saying a few years ago. As a result, the budget we agreed upon last year was a turnaround. I think one problem was when that turnaround occurred, everyone yawned. And Congress, always wanting public approval, then decided, "Well, we have to do something newer and more dramatic." If there had been headlines, "Congress Changes the Direction of the Federal Budget for the First Time in Decades," you might not have Gramm-Rudman-Hollings.

Change will occur. It will occur incrementally with or without Gramm-Rudman-Hollings. Our system is not designed for radical change -- except, as Barber said, in times of crisis or with strong Presidential leadership, which this President has the tools for, but the inability or unwillingness to use on this issue. Otherwise change will occur incrementally.

FRANK DELAY: One thing not yet mentioned is the belief on the part of Members of Congress that there is a direct relationship between the amount of money that is spent in their districts and their reelections. That raises the horrible fear that when you talk about the reduction of middle class entitlements, you are not talking about the reduction of the budget at all. Rather you are talking about making no money available for reelection.

DR. NORMAN ORNSTEIN: Are you talking about the franking privilege

or the rest of the budget? The basic fact is that over the last 20 years the share of the budget that has gone to any of the particular benefits that could go to districts has declined dramatically. The whole notion which is built into the public choice literature that Professor Buchanan cites, that there is an overwhelming institutional bias for individual Members of Congress to glom onto more and more for their individual districts is totally belied by the evidence of the last 20 years.

BARBER CONABLE: Let me close this session by reminding all of you, I spent most of my time in Congress fighting dams in my district.

BROWSER'S GUIDE

Session III

Budgets and Interest Rates:
The Relationship Between Fiscal and Monetary Policy

This session was a bridge between the first two (economic and political importance of the norm of budget balance) and the fourth (sectoral impacts). Both logic and the style of the participants operated to make it an effective transition.

First, the discussion continued from the morning. John Brademas, former Congressman from Indiana, President of New York University and Chairman of the Board of the Federal Reserve Bank of New York, spoke not about monetary policy but about the need for budget compromise. He spoke explicitly as the President of the world's largest private university. Like the morning speakers before him and those who would follow, Dr. Brademas spoke of a package. The amount of pain he wished to have inflicted on his preferred priorities was limited, but that too was a theme that ran throughout the meeting.

This session serves logically as a bridge because the mismatch between fiscal and monetary policy has economic and political consequences -- and the consequences vary across sectors of the economy. When monetary policy is aimed at reducing and then preventing any recurrence of inflation while fiscal policy is stimulative, the result is high real interest rates and an overvalued dollar. This conflict between the goals of fiscal and monetary policy has placed a heavy burden on those sectors of the economy most sensitive to interest rates and foreign competition.

The mismatch between monetary and fiscal policy generally is held to have worsened the recession in the early 1980's -- especially for those parts of the economy.

Representatives Latta and Slattery both spoke of the need for deficit reduction in terms of its relation to monetary policy. Both noted signals from the Federal Reserve that fiscal restraint would be rewarded with a more accommodating monetary policy. Both called for action on the budget deficit before the general economic climate in the nation deteriorated.

U.S. fiscal and monetary policies in recent years have been directed toward different goals. Since 1979 monetary policy has been aimed first at reducing inflation and then at preventing its recurrence. Thus, the Federal Reserve restrained the growth of money and credit. In contrast, fiscal policy has focused on growth. Congress has enacted five successive budgets more or less consistent with aggregate spending and tax levels proposed by President Reagan. Since 1982 fiscal policy has been highly stimulative.

The conflict between fiscal and monetary policy was evident as government's competition with the private sector for a strictly limited supply of credit pushed up real interest rates. Given the Federal Reserve's

determination to wring inflation out of the economy, stimulative fiscal policy increased the burden borne by monetary policy and exacerbated pressure on interest rates.

Monetary policy is a blunt instrument. Its effects are unevenly spread throughout the economy, hitting hardest in certain sectors: housing, agriculture, exports, import-competing industries.

Earlier comments -- especially those by Manuel Johnson and Franco Modigliani -- have addressed the question of the relationship between deficits and interest rates. Historically, high deficits and high real interest rates have not occurred together (historically the United States has not run high deficits in peacetime in periods of economic recovery). Neither has there been historically any consistent pattern of growing deficits and growing GNP. The issue for current policy is not whether there is some immutable link between high deficits and high interest rates. Rather it is: when fiscal and monetary policy conflict the cost of controlling inflation is unequally distributed across the economy; and the nation may pay a high price in terms of slower and/or uneven economic growth.

DR. JOHN BRADEMAS
President
New York University

January 10, 1986

I am honored to have been invited by my old friend and colleague, Bob Giaimo, to take part in this conference; and I congratulate him and another good friend and former colleague, John Rhodes, the Co-Chairman of the Committee For A Responsible Federal Budget, and indeed, all those groups and persons who have made possible this discussion today.

I find it hard to believe that come the first of July, it will have been just five years since I left Washington, D.C., for Washington Square.

And I may say to my old colleagues that in our days on the Hill, we used to make lots of speeches, raise money, wrestle with a variety of constituencies, resolve conflicts and deal with massive egos.

So I must tell you that I feel very much at home as university president!

More seriously, one of the advantages of my new life at NYU -- aside from not having to run every two years -- is the opportunity to serve on various boards and commissions, an experience that would not have been appropriate for a Member of Congress.

So beyond by responsibilities at the university, I have the privilege of chairing the Board of the Federal Reserve Bank of New York and of Governor Cuomo's New York State Council on Fiscal and Economic Priorities as well as serving on various corporate and foundation boards, including the New York Stock Exchange.

Such service has given me, I hope, a broader appreciation of the outlook and concerns of the leaders of private business and industry in our country.

Moreover, the university I am privileged to lead, New York University, is itself an enterprise of considerable size and complexity. With some 47,000 students, 14,000 employees and an annual budget exceeding \$700 million, NYU is the largest private university in the world.

So it is against the background of these experiences as well as twenty-two years as a Member of Congress from Indiana that I should like to offer a few remarks today to get our session going.

After I have spoken, I understand that Bob Giaimo will serve as moderator and we shall hear some comments from each of our guests on the panel and then plunge into what I am sure will be a lively discussion.

That this is a symposium on "Budget Balance" and that it is sponsored by a "Committee For A Responsible Federal Budget" indicates at

least an apprehension that right now our national government does not have such a budget.

Some speakers at this conference have reported to us that the American people may not be desperately alarmed about \$200 billion deficits in the budget while other observers here insist that there is deep public concern.

Whatever the state of popular opinion on this matter, however, there can be no doubt whatsoever that Congress is certainly and genuinely fearful about the explosion over the past five years in the size of the deficit.

I remind you that the deficit has gone from approximately \$60 billion, when Jimmy Carter left Washington, D.C., to a figure in excess of \$200 billion in Ronald Reagan's years in the nation's capital.

This concern is most dramatically manifested, of course, in the approval by Congress and President Reagan of the Gramm-Rudman-Hollings Act.

Others here either have explained or will spell out the mechanics of this legislation.

I think that all of us will agree, whether we favor Gramm-Rudman-Hollings or not as an instrument for balancing the budget, that the measure clearly poses a variety of problems. It is a highly controversial law and the difficulties it raises are, in my view, serious and substantial.

What are some of them?

In the first place, there are questions as to the constitutionality of Gramm-Rudman-Hollings. The Justice Department has already charged that by allowing the intrusion of the Comptroller General into decisions on budgetary priorities, the statute violates the separation of powers. Such major governmental policies should be set by elected officials runs the argument.

Congressman Mike Synar of Oklahoma and a congressional group he leads add that Gramm-Rudman-Hollings abdicates legislative power -- to decide on expenditures of public monies -- to the executive.

Second, whether the courts hold the law constitutional or not, beyond dispute, Gramm-Rudman-Hollings raises issues concerning the appropriate institutional roles of the executive and legislative branches of our government.

Has Congress -- constitutionally or not -- surrendered its most cherished authority, the determination of priorities in spending tax dollars, to the executive branch?

Third, Gramm-Rudman-Hollings raises grave economic issues.

For example, in its January 20 issue, *Fortune* magazine voices alarm that the deficit will rise to \$230 billion in fiscal 1987.

Fortune asserts, with respect to fiscal '87, which, of course, starts next October, that in order to meet the Gramm-Rudman-Hollings targeted deficit of \$144 billion, it will be necessary -- if we accept the Administration's estimates of 4 percent economic growth -- to have cuts of \$50 billion.

But Fortune believes that the economy will grow only half that fast and that the consequent lack of revenues will mean that to meet the target will require budget cuts in the order of \$85 billion.

Cuts of this size, asserts Fortune, will clearly stop the economy dead in its tracks. The result of Gramm-Rudman-Hollings will be recession.

A fourth issue raised by Gramm-Rudman-Hollings has to do with the nation's foreign and military policy.

If the automatic budget cutting mechanism required by Gramm-Rudman-Hollings comes into play, not only will there be deep slashes in foreign aid, but more dramatically still in defense spending.

Cap Weinberger has certainly found it easy to suppress his enthusiasm for Gramm-Rudman-Hollings because he understands -- if President Reagan does not -- that half the cuts required will come out of the hide of the Pentagon.

Les Aspin, Chairman of the House Armed Services Committee, has patiently attempted to explain this point to Mr. Reagan but apparently without success.

Only this week I talked to a former Chairman of the Joint Chiefs of Staff and last week to the senior Senator from New York, Pat Moynihan, and heard both of them voice genuine fear that the Reagan-Grumm-Rudman Act, which is what it should properly be called, will have a devastating impact on the nation's military strength. Both Weinberger and Moynihan agree that the result will be to undermine the U.S. position in bargaining with the Soviets on arms control.

Fifth, the effect of Gramm-Rudman-Hollings on an array of domestic programs has, in my judgment, yet to be understood by the country.

Because several items are exempted from the automatic cuts in the statute -- approximately 70 percent of the budget is exempt -- including interest on the national debt, social security, welfare and certain low-income programs, and because half the mandatory cuts come from defense, most of the burden of the other 50 percent will fall very heavily on such areas as health, education and transportation.

Indeed, if we are to meet President Reagan's goal of increasing military spending in real terms by 3 percent, without any new taxes, it will be necessary, in order to meet the Gramm-Rudman-Hollings target of \$144 billion in 1987, to eliminate 30 to 50 non-military federal programs.

As president of a university where 80 percent of our students work and over two-thirds receive some form of financial aid, most of them in

the form of federal loans and grants, I can tell you that our projections are most depressing.

Gramm-Rudman-Hollings could have a most damaging impact not only on student aid but on health research as well, much of which is, of course, conducted by universities.

Now as I have referred to sharp cuts in aid to college and university students and for university-based research as examples of the impact of the automatic budget cuts of Gramm-Rudman-Hollings, I am here reminded of yet another issue raised by its passage.

This legislation, aimed at producing a balanced budget, will come into play at exactly the same time that Congress is acting on a major bill to change the nation's tax laws.

And as everyone knows, to President Reagan, an essential requirement of a tax reform bill is that it be revenue neutral.

So here we have two trains running through Washington, D.C., simultaneously, each with profound potential impact on the nation's economy but driven by different assumptions about the nation's economic needs.

Gramm-Rudman-Hollings was passed on the assumption that bringing down the deficit is essential; the tax reform bill is premised on the assumption that it must not produce deficit-reducing revenues.

But having alluded to the damage that Gramm-Rudman-Hollings could work on higher education as just one concrete example of the effect of the legislation, I must now say a word about the tax reform bill passed last month by the House of Representatives.

There are provisions of that bill for which I have great sympathy, and I congratulate my former colleague and friend, Dan Rostenkowski, the distinguished Chairman of the Ways and Means Committee, on his masterful leadership in moving his bill across the minefield of the House of Representatives without losing an arm or a leg. That was no mean feat.

Allow me, however, also to express concern about some aspects of the bill that mean great potential harm to the nation's colleges and universities.

I shall try to be succinct and give but a few examples.

First, the bill would seriously undermine giving to colleges, universities, hospitals, museums and other charitable institutions.

Second, the bill would tax scholarships and fellowships to the extent that students did not use the stipends for tuition and equipment, a heavy blow, for example, to graduate students who need support for room and board.

And third, the bill would impose onerous restrictions on access to

tax-exempt financing on the part of private colleges, universities and hospitals like NYU while continuing full access to such financing by public colleges, universities and hospitals.

The result of this particular provision would, for the first time I know anything about, mean that federal policy would place private colleges and universities in an inferior position to our public counterparts. This is most unwise and unfair public policy.

In fact, only the splendid help of Congressman Charles Rangel of New York, with the support of Chairman Rostenkowski, protected New York University on the tax-exempt bond question in the bill just passed by the House.

There are other dangers to independent charitable, private, non-profit organizations, but I cite only these to make my point.

So what have we here?

We have -- and I cite the example of federal policy toward higher education both because it is the area I know best and because it is an instance of the kind of problem I have been describing -- a case where a sector of American life crucial to the future strength of our country, economically, militarily and in other ways -- higher education -- is being subjected to a triple whammy.

Gramm-Rudman-Hollings, in the first place, would impose severe cuts on federal funds for student aid and university research and for other purposes.

Yet the tax bill just passed by the House would add huge new financial burdens to the backs of private, non-profit universities and hospitals while at the same time denying such institutions the instruments we need to generate contributions from the private sector.

By this example then, I have attempted to give you at least an illustration of another range of problems represented by Gramm-Rudman.

Having spoken of the relationship, or more accurately, the lack of relationship, between Gramm-Rudman-Hollings -- aimed at reducing the budget deficit -- and the tax reform bill -- aimed at revenue neutrality -- I must add still another dimension to our deliberations: the internationalizing of the economy.

For clearly, the tremendous U.S. trade deficit -- now running at record annual rates -- is one of several distortions in the domestic and world economies that are rooted in our high budget deficits. The extraordinary strength of the dollar, pushed up by these record deficits and high interest rates, has accelerated American imports and depressed exports. And the United States has had to depend on inflows of capital from abroad to finance our budget deficits; we are today a debtor nation.

And finally, the drive to balance the budget through Gramm-Rudman-Hollings raises questions of domestic politics.

They are questions for President Reagan and for all the Members of the House of Representatives and the one-third of the Senators seeking reelection next year.

Will the President's support of Gramm-Rudman-Hollings drive a further wedge -- we have already seen his problems in winning Republican votes for his tax bill -- between him and the Republicans on Capitol Hill who must justify to their constituents their support for savage cuts in programs those constituents deem essential?

Will the Draconian slashes in these programs cause the Republicans such problems as to lose control of the Senate this year?

Or will the opposition on the part of both Republicans and Democrats in Congress to reductions in domestic programs be so strong as to cause Mr. Reagan -- as the price of protecting his defense budget -- to yield to a tax increase, call it by any name one wishes?

Now I've given you at least some of the issues that seem to me are generated by the momentum for a balanced budget, at least as symbolized by and incarnated in Gramm-Rudman-Hollings.

Allow me to conclude with a brief editorial comment.

My own view -- and I speak from a distance now and not from the cloakrooms of the House of Representatives -- is that there is a golden opportunity for the building of a consensus on getting control of the Federal budget deficit.

Whether that opportunity has come and gone, I cannot say.

But I believe that for some months now, the chance for a bicameral, that is to say, House and Senate, and bipartisan, that is to say, Democratic and Republican, accommodation on the federal budget has been there, waiting in the wings, yearning to be born.

What are the components of this accommodation?

I think they are three:

First, slow the rate of defense spending. Notice that I do not say cut the military budget but rather reduce the rate of its growth.

Second, increase tax revenues.

Here I interject that there seems to me there can be no denying that the principal causes of the \$200 billion-plus deficits the nation is now experiencing are the direct and predictable consequences of the combination in 1981 of Mr. Reagan's huge tax cut and his huge increase in military spending.

If there can be agreement on these two points -- to repeat, slowing the rate of growth in defense spending and increasing tax revenues -- the third component of the consensus is to limit certain domestic

expenditures, including such programs as veterans' and civil servants' benefits, subsidies for farmers and businessmen, and Medicare.

I believe, based on their public statements, that Bob Dole and Tip O'Neill, Pete Domenici and Jim Wright, Lawton Chiles and Bob Michel -- and perhaps even Del Latta and Jim Slattery! -- could agree on the kind of accord I have outlined.

The problem, therefore, at least in my view, has not been so much Congress and has not been so much the Democrats and Republicans on Capitol Hill.

The problem -- the missing ingredient here -- has been the President of the United States.

For so long as Mr. Reagan says "no" to a slowdown in the rate of growth in defense spending and so long as he vehemently rejects any increase in tax revenues, and so long as he insists that the budget of the government of the United States will be balanced only through tax revenues produced by supply-side economics combined with cuts in domestic programs -- so long as he takes that position, there will be no serious progress toward either a balanced budget or a responsible federal budget.

And let me conclude by observing that the two are not always necessarily the same!

BUDGETS AND INTEREST RATES;
THE RELATIONSHIP BETWEEN FISCAL AND MONETARY POLICY

by

Delbert Latta
Ranking Minority Member, Committee on the Budget
United States House of Representatives

January 10, 1986

First let me say, the temptation is strong to throw away my prepared remarks and respond to my good friend and former colleague, John Brademas. I must say John hasn't changed at all since he was in the House. His arguments, and his concerns, are essentially the same as they were then. But out of deference to Bob Giaimo and John Rhodes, to the Committee for A Responsible Federal Budget and all the other groups who have contributed money and worked hard to bring us all together today -- and out of deference to the seriousness of the issue we are asked to address in this session -- I will say what I came here to say.

Mainstream economists long have supported the proposition that government borrowing must compete with investment borrowing for the pool of funds that individuals are willing to lend.

Large deficits, it has been argued, lead to higher interest rates and "crowd out" productive investment.

We have been warned that a hyper-stimulative fiscal policy will collide with a restrictive monetary policy, bringing on new waves of skyrocketing interest rates and inflation.

However, many of the predicted short-run effects of large deficits have not materialized. Consider the following:

- With government spending over 24% of GNP and the accumulation of \$2 trillion in Federal debt, interest rates as measured by Treasury's 3-month bills are at less than half of their 1981 peak levels.
- Although deficits were expected to lead to weak investment and a weak recovery, both real business investment and real GNP growth in the current recovery are relatively strong.
- Inflation as measured by the Consumer Price Index (CPI) has been cut by two-thirds from its 1979 peak and remains low.

I could go on. These developments would seem to indicate that deficits have little effect upon monetary policy or interest rates.

Well, let us not draw any quick conclusions.

Unabated spending by Congress and the resultant huge deficits

have been overshadowed for the present by other economic factors.

- Interest rates declined because of an accommodating monetary policy at crucial points. (I have in mind, particularly, the policy change at the Federal Reserve in August - September 1982 which helped significantly to end the recession of the early 1980's.) Although, other things being equal creating more money creates a higher level of prices, the velocity of money (M1) has declined, thus mitigating possible adverse effects.
- The record appreciation of the dollar, downward pressure on raw material prices, and smaller wage increases have had a significant beneficial impact on inflation.
- The rapid buildup of government debt has been accomplished by an increasing net inflow of foreign capital. To the extent foreigners buy U.S. assets, they release domestic savings for purchases of government debt. Last year, about one quarter of our net needs for investment were met by foreign sources.

Regardless of these factors, it is inevitable that the long-predicted clash between a stimulative fiscal policy and a more restrictive monetary policy will occur.

We should not be lulled into a false sense of security. The underlying imbalance between deficits and the private sector's ability to finance them will widen with disastrous consequences unless spending cuts are made or revenues are increased. Frankly, I prefer the former.

A consequence of continuous large deficits is the decline of capital formation. Federal debt held by the public is expected to increase from 40% of GNP in 1985 to nearly 50% in 1990. As our ability to finance private investment is slowed by the accumulation of public debt, growth will slow and productivity will decline, with obvious effects on personal income and consumption.

This "crowding out" could be mitigated by further foreign investment or by the Federal Reserve acquiring government debt. The likelihood of either or both happening does not appear high.

Although there is no automatic relationship between monetary and fiscal policy, a linkage does exist. While Congress and the Administration set fiscal policy independent of the Federal Reserve's monetary policy, the outcome of fiscal policy choices may influence directly the Federal Reserve's choice of monetary growth targets and so influence interest rates.

Deficits that are created through the legislative process will, other things being equal, cause pressure on interest rates as government competes for funds. This situation will prompt a reaction from the Federal Reserve. If the focus of Federal Reserve policy is to keep interest rates within a target range, it will inject funds into the

system. That will increase the monetary aggregates and ignite fears of inflation. On the other hand, if the Federal Reserve places greater emphasis on limiting monetary aggregates and the growth of debt -- both private and government -- the Federal Reserve may shrink the money supply and push up interest rates. This would force all borrowers, including the Federal government, to pay more for the use of money.

The link between fiscal and monetary policy is interest rates. This link was stated by Federal Reserve Chairman Paul Volcker in testimony last year before the House Budget Committee. Volcker said that a reduction of about \$50 billion in the federal deficit would probably bring about a reduction in interest rates of one percentage point.

The fact that the Federal Reserve chairman can quantify the amount of deficit reduction needed to cut interest rates is evidence of the relationship between fiscal and monetary policy.

Volcker stated further, and categorically, that the various economic factors currently helping to alleviate the consequences of a big deficit could not continue to operate indefinitely. I agree. Monetary policy, although sufficient to sustain growth in real output and employment, could not resolve the underlying fiscal problem. Eventually inflation and higher interest rates will return if we don't cut the deficit.

Congress and the Federal Reserve each have tried to accommodate the other, with the Federal Reserve being more successful. Congress, however, cannot continue to place such a large burden on the Federal Reserve. Eventually the Federal Reserve will be forced to address the long-term effects of a stimulative fiscal policy at the top of the economic cycle. The Federal Reserve cannot accommodate \$200 billion deficits in this situation without causing an explosion in monetary growth.

A long-term danger of persistent huge deficits is that the Federal Reserve might decide to increase its purchase of government debt. If deficits began to push up interest rates, the Federal Reserve might seek to relieve this pressure through so-called debt monetization. The result would be an expanding monetary base which could lead ultimately to rapid inflation.

Finally, and somewhat overlooked in the debate, are the consequences of deficits for federal policy as it applies to the delivery of government services.

Interest on the debt now consumes 14% - 15% of the total budget, more than double the percentage in the mid-1970's. We will spend \$150 billion this year on interest charges. That amount will grow to \$220 billion by 1990, unless we do something to change the path of the Federal deficit. This growth in interest can only be accommodated either by raising taxes or by cutting spending for other Federal programs.

Those who argue that tax increases are needed to reduce the deficit ignore the evidence of past Congressional behavior and economic reality.

Revenues have risen in nominal dollars nearly 100% since 1978. Even after the Kemp-Roth tax cut, receipts as a percent of GNP are slightly higher today than they were ten years ago. (18.3% of GNP in 1975. 18.6% of GNP in 1985.) Revenues go down during recessions, they go up in periods of economic recovery.

But by any measure Federal spending has increased dramatically. Since 1978, actual federal spending has increased 112%. Perhaps more to the point, Federal outlays have risen by an amount equal to 2.2% of gross national product in the last decade. Many seek to blame this increase on the President's effort to rebuild our national defense. Again, this runs counter to the evidence. Defense spending, as a percent of GNP, declined from 9.6% in 1962 to 4.9% in 1979. It has now risen to 6.8% of GNP. Conversely, entitlements and other mandatory spending programs have risen from 5.7% of GNP to roughly 11% of GNP over the same period.

Those who clamor for higher taxes to reduce the deficit would use those higher taxes instead to protect domestic programs from budget cuts. I would favor taxes for deficit reduction only if the revenues could be placed in an iron-clad trust fund for use exclusively to reduce the deficit.

Many of the same people who want a tax increase often decry deficits but push for deep spending cuts only in national defense. Some in Congress suggest that major reductions in the defense budget could narrow the budget deficit. But, I ask you, at what cost to our security? The American people have considered this option and by reelecting President Reagan in a landslide they made their position clear. They have opted for a strong national defense.

Needed deficit reduction may have some adverse effects in the short run. Those who receive the benefits from Federal spending will suffer more than others. Inequities exist in every system. However, we must act now to minimize the damage to the present economy and the burden on future generations.

The possible contractionary effect of deficit reduction could be cushioned by other factors. Reducing Treasury's borrowing needs surely would relieve upward pressure on interest rates. The dollar would decline, and that in time would strengthen net exports. Moreover, if interest rates rose or the economy seemed to react negatively to the short-run change, the Federal Reserve could shift to a somewhat more expansionary monetary policy without much fear of inflation. *

More importantly, a credible long-term deficit reduction package should cause a further decline in real interest rates. Bear in mind that although nominal rates have declined, real interest rates are at a near-record high.

It could be argued that real interest rates could come down in line with past behavior if the budget were closer to balance. Interest rates then would respond more to the actual ebb and flow of inflation rather than to expectations (or fears) -- or to critical factors outside our

control such as inflows of foreign capital.

Without the net inflows of savings from the rest of the world, the deficit's pressure on interest rates would be much greater. The budget deficit is a loaded gun pointed at the heart of the U.S. economy.

Inflows of foreign capital have, for a time, kept the safety on. But as I said before, we cannot control directly foreign investment in the U.S. If international funds are withheld or withdrawn (if foreign investment just levels off -- if it fails to continue to increase) it is likely the dollar will plummet and interest rates will rise.

It would be sound policy for our government to reduce our current reliance on foreign capital and abandon the hope of continued easy money. Deficit reduction through real spending reduction will increase investor confidence and help ensure the long-term health of the nation's economy.

The Federal Reserve then could pursue a growth policy without having constantly to weigh the detrimental effect of our massive deficits.

The recently enacted Gramm-Rudman-Hollings legislation to balance the budget over a five-year period could -- if it is constitutionally upheld -- and if it is not violated by Congress -- help ease the upward pressure on interest rates.

Just the expectation of reduced Federal borrowing has already had some very beneficial effect on long-term interest rates. Some optimists already are saying we have reached an historic point in our nation's economic life and that the pall which big deficits cast over our future may be lifting. Who knows? Our fiscal and monetary policymakers may now work together and bring about the non-inflationary economic growth this great nation is capable of achieving.

Let me say in closing, clearly I believe there is a relationship between fiscal and monetary policy -- that continued very large deficits eventually must produce high interest rates and/or inflation. But even if I did not believe that, I still would argue we must move the budget back toward balance. This is not just an economic issue. It is a moral issue. We cannot continue to spend like drunken sailors and pass the bills on to our children.

BROWSER'S GUIDE

Session IV

The Effect of Deficits on Selected Sectors of the Economy

This panel offered a kind of guided tour across sectoral concerns with the deficit: trade, the elderly, the States, manufacturing, big business.

Representative MacKay talked about some of the less discussed impacts of the deficit. Retrenchment is difficult enough if priorities are established. If the challenge of international competition, however, dictates rearranging existing spending -- to invest more in education and in research and development -- then deficit reduction becomes even more complicated. What about the State governments? Will Congress remove Federal funding without removing Federal directives? Will the States be left with programmatic rigidities and no financial assistance? What about traditional relationships within Congress? How should the Budget Committees relate to other committees? What about traditional relationships between Congress and important constituencies, especially agriculture and the elderly? What happens when deficit reduction runs headlong into sacred areas? Representative MacKay commented that the agriculture community had not come to grips with this challenge but that the AARP had been increasingly willing to play -- as long as everyone else was in the game.

Representative Bonker talked about the trade sector. Today there is general recognition that the fiscal deficit and the trade deficit are linked. At the same time Members of Congress are not elected to ignore the pain felt by their constituents -- and a loss in competitiveness causes real pain. Resistance to protectionism would be made easier if the economy was healthy and the trade deficit fell. Otherwise, it will be hard to expect Congress to sit back and wait for deficit reduction to lead to an improved trade situation.

The other panelists appeared more in the role of representatives from specific sectors or groups. This may have limited their freedom or candor, especially as their remarks relate to issues important to the constituencies they represent. Their remarks should be read as much for what was not said as for what was stated.

Cyril Brickfield of the AARP elaborated on the economics of their membership and reminded the audience of the sacrifices already made by the elderly. He reminded his listeners that by itself the social security system is solvent. Mr. Brickfield went on to stress the need for a package approach to deficit reduction, for keeping everything on the table. Slowing the growth in defense and an increase in revenues must be part of the package, he said. There was deafening silence during Mr. Brickfield's presentation on one key item: there was no refusal to consider additional sacrifice (read cuts in programs important to the elderly) as long as those other conditions are met. Recalling the public

nature of the forum, and the temptation to practice, "yes, but" deficit politics, this nonrefusal may have been as notable as any point actively expressed during the Brickfield presentation.

Alexander Trowbridge, President of the National Association of Manufacturers, also advocated a package. His preferred package includes COLA reductions and other spending cuts. His paper is explicit as to the dangers of a tax increase. Yet, again, the seeds of compromise are there: a tax increase is total anathema unless the spending cuts are locked in -- unless any tax increase is held hostage to ensure spending cuts actually go into effect. If those conditions are met...the conclusion is left unstated.

Governor Carlin spoke to the damage done the States by the Federal government's budget paralysis. States must cope not only with the negative economic effects of a high Federal deficit, but also with the negative effects of the way in which Congress goes about reducing that deficit. The Governors prefer deficit reduction with a loss of aid to no action. The inability to plan and the uncertainty about Federal action is a disaster even for economically healthy States. Interestingly enough, except for a slightly greater acceptance of a tax increase, the deficit reduction package advocated by the Governors looks a great deal like the package advocated by Mr. Trowbridge!

If Mr. Brickfield was supposed to offer one end of the spectrum of views on deficit reduction, Joseph Flavin, CEO of Singer Co., speaking on behalf of the Business Roundtable offered the other. Mr. Flavin spoke fervently about excess spending and restoring government to basics. He seemed to slam the door on any tax increase under any circumstance. However, he was not asked about the Business Roundtable's official position -- which looks very similar to what Mr. Trowbridge seemed to imply: an increase in revenues may receive their support, but only inside a package which guarantees major structural spending cuts as well. It may be the seeds of compromise could take root here as well -- they may just be buried a little deeper. But, Mr. Flavin made clear his belief that Federal spending is too high -- that from his point of view the way to cut the deficit is to cut spending.

The commentators noted the similarities and differences -- and highlighted some other "winners and losers." The session was less a coherent whole than a menu of possible deficit reduction packages. Most interesting was the common ground among all the menus suggested, and the very real sense that almost everyone is willing -- or soon will be -- to compromise.

DON BONKER
Chairman, Subcommittee on International Economic Policy and Trade,
Committee on Foreign Affairs
United States House of Representatives

January 10, 1986

I am sure by now all of you have heard all you care to know about budget deficits. But come mid-February, my colleagues and I will have to roll out of bed in the morning and face the harsh realities and very difficult choices that will come with Gramm-Rudman-Hollings.

I am reminded a little of the story about the young boy resisting getting out of bed to go to school. His mother argued with him about his responsibilities saying he had to get out of bed. He protested, finally saying, "Mother, give me one good reason why I should get out of bed and go to school." She said, "I can do better than that. I will give you two good reasons. Number one, you are forty-five years of age; and number two, you are the principal." So, too, we will have to struggle one morning soon to assume our responsibilities.

I do not need to restate the universal truths about the relationship between budget deficits, exchange rates, and our trade problems. We all know now that huge deficits must be financed and that they have been increasingly financed by foreign sources. Some estimate international investors finance as much as half of our deficit. Capital inflows of this magnitude have sent the dollar soaring relative to other currencies -- to an average level last year 30-40 percent above the 1980 level, and this in turn has caused unprecedented, and perhaps threatening, trade problems for the United States. We ended in November with an accumulated 1985 trade deficit of around \$131 billion; so we will easily top \$140 billion, but are likely to be a little under the \$150 billion trade deficit estimated for 1985.

Now we are also becoming accustomed to our new status as a debtor nation. This year the U.S. will become the largest debtor nation in the world. We will make Mexico, Brazil, and Argentina look like pikers.

The causes of the trade deficit are many. First, most economists and officials say up to 75-80 percent of the increase in our trade deficit is caused by the other deficit, the budget deficit. Second, the sagging economies of our trading partners hurt: there have been no stimulative policies in Europe, and slow growth there has cost us sales. Of course, they point out that the U.S. is sucking capital from their economies, denying them funds for investment and keeping their interest rates high.

Third, the debt crisis in third world countries further exacerbates the problem: Those recycled petrodollars really stimulated Latin American economies in the 1960s and 1970s and resulted in large purchases of U.S. products. Today, many of them are in serious trouble and implementing very harsh economic austerity measures to get their financial houses in order. Sales to Latin America have plummeted.

Fourth, of course, we have unfair trade practices. Whenever Congress

wants to deal with the problem, we talk about unfair trade practices, but that really accounts for no more than 6 or 7 percent of our overall trade deficit.

Finally, there are other contributing factors such as foreign policy controls, national security controls, and declining productivity. The other day when the President announced that he was going to slap more economic controls on Libya, it was the eighth time he has used his authority to abrogate contracts and deny business opportunities in foreign countries. This kind of control has never worked as intended. Yet, it does have an unintended effect. The Young Commission on Industrial Competitiveness in America estimated that we lose \$14 billion a year because of our government's export control policy. I'll leave the discussion on productivity for another day.

What is our government doing about the trade deficit? First, we are attempting to deal with the fiscal deficit via Gramm-Rudman-Hollings, budget resolutions, reconciliation, etc. That subject has been discussed extensively; I do not need to add much. I will note that there is a new consciousness in the Congress about cutting the budget. No longer do the cities and counties and others who come to us pleading for revenue sharing get a responsive smile in the Congress. In fact, the smile is in reverse. We are now saying, "Sorry chaps, we have got to get on with deficit reduction." It is easier to say no than it has been in past years. Dealing with the budget deficit is the most critical step in trade policy.

Second, we have got to look at international monetary policy. Until just a few months ago, this administration, if anything, extolled the virtues of the strong dollar. Secretary Baker's meeting with his counterparts in New York on September 22, evinces a new collective recognition that there is a misalignment problem and that it must be dealt with. There is even an implied commitment to a strategy of intervention. It is a rather belated response, but a welcome one.

Congress really cannot do much about international monetary reform and currency misalignment. We can hold hearings, and we have. Various task forces have now recommended that we tie the President's call for a new round of trade talks to our call for international monetary reform. There are proposals circulating: Senator Bradley's to establish a strategic currency reserve and so require intervention in some circumstances; Congressman Lundine has another.

Lastly, there is trade policy. This year you will see the Ways and Means Committee and other committees in the House and Senate taking up trade policy. We lack a comprehensive trade policy in this country, and I doubt if we will ever have one. At least we are trying to deal with the problem. Both the Senate and the House have set up task forces that have offered very positive recommendations on how we can bring down the trade deficit. We have flirted, as you know, with protectionist legislation. The textile bill, which passed by a sizeable margin in both the Senate and the House, is contrary to international trade law and our multilateral agreements. It is blatantly protectionist. Thank goodness the President vetoed that legislation.

We have heard serious recommendations to impose an across-the-board surcharge on all products from countries with whom we have a very high bilateral trade deficit. The threat of protectionist legislation is very real

in the Congress. However, this year, I think you will see both the Senate and the House, in pretty much a bipartisan way, try to write generic legislation: legislation to beef up our trade laws, to improve export promotion, to increase and improve assistance to industries heavily damaged by imports.

I think we all recognize that time is running out if we are going to deal effectively with our twin deficits. The type of congressional action on the trade problem, protectionism or not, will depend on two principal factors: the overall state of our domestic economy and the trade deficit. Everywhere you look across the economic landscape of the United States, it is not difficult to see that vital manufacturing jobs are being lost, that industries are shutting down. Sandy Trowbridge could probably attest to that fact. Many communities in my district, many communities across the nation are suffering because of this restructuring of our industrial base in this country. However, we always look for a scapegoat, and the scapegoat is going to be imports. Until we have a more sophisticated view, this is going to lead directly to political pressure on Congress to go along with protectionism.

As to the trade deficit as a barometer, I have told Japanese officials who have come to the United States that if the trade deficit goes up, so will the pressure on Congress to do something. If the deficit goes down, the pressure goes off.

In conclusion, I think that I can agree with Bob Strauss, who recently said that trade is a ten-year affair that must be settled by major powers working together.

REPRESENTATIVE BUDDY MACKAY

January 10, 1986

I will begin in the best political tradition, with an irrelevant story.

The story is told of a procedure utilized in the State of New York during the nineteenth century as a test of insanity.

The suspect was led into a room in which there was a bucket with an open spigot allowing water to run into the bucket, and was handed a dipper and told to empty the bucket. If the suspect began dipping without the spigot off, he was ruled insane.

Our annual budget battles over the past five years have literally been an effort to empty the deficit bucket by dipping frantically for three or four months each year, while ignoring the fact that the spigot is running wide open all year long.

So my answer to the basic question raised by this conference is: No, we have not abandoned the basic norm of a balanced budget. The problem is that our budget process is clearly schizophrenic. We are dipping with the spigot running. The recently adopted budget balancing procedure is crude and inelegant. It does not specify who holds the dippers, or the places from which the deficit will be dipped, but it does require that the spigot be shut off. In that respect, it is a major advance from our present budget process.

The Gramm-Rudman-Hollings procedure has been called a lot of names, some of them not very complimentary. From my point of view, the adoption of such an unprecedented procedure was the decision by Congress and the President to begin chemotherapy. As with chemotherapy, you do not undergo it unless you acknowledge you are seriously sick. Also, as with chemotherapy, you anticipate major pain and side effects. I will sketch a few of these.

First is the impact on America's effort to deal with the problem of competitiveness. How can we divert resources into investments in the future, like civilian research and development and broadened higher education opportunities in science and mathematics, while simultaneously reducing the budget deficit?

Second, what about the impact on other levels of government and the private sector? (There is a story about the cross-eyed shot-putter. He never set any records for putting the shot, but you never saw anyone like him for keeping the crowd on its toes.) I would say to those on this panel and in the audience who represent State government and the private sector that you had better watch out for your toes. The easiest way to balance the federal budget is to cut transfers to state and local government, and also to shift the cost of regulatory programs from the federal budget to the private sector. I understand this is widely done in Europe, in the form of requirements for third party certification,

instead of inspection by federal bureaucrats. Why have inspectors on our federal payroll, when we can just as easily require you to hire engineers or inspectors at your own expense?

Third, the impact on the Congress: Initial commentary on Gramm-Rudman-Hollings centered on its potential to transfer power from Congress to the President. While not denying that, many of us believe that the most significant changes will be changes of traditional alliances between constituency groups, as well as transfers of power within Congress itself.

Consider the plight of agriculture. Traditionally, agricultural advocacy groups have been in the forefront of the effort to reduce the deficit, while also benefiting from dramatic spending increases. Because the money spigot has been left open, there has been no necessity to reconcile these obviously contradictory positions. Under Gramm-Rudman-Hollings, agriculture is fully exposed to the automatic spending cuts. This means that within the next nine months, farmers are going to understand the pain of balancing the budget. During that time, their programs will already have been reduced almost 10%, and will face four more consecutive years of equally drastic cuts.

How will this impact on the traditional alliance between agriculture and defense, when farmers come to understand that the price of the military buildup is a decimation of their programs?

The same may be said for non-social security retiree groups, who have probably seen their last COLA until 1991. How will they feel about social security being totally exempted, while they continue to be put through the wringer?

What about the relationship between the Budget Committee and other Committees? Bob Giaimo formerly chaired the budget Committee, and lived with the frustration of trying to enforce discipline in a system where the people with the power stood to benefit by causing the budget process to fail. That was true then, and it still is true today. Other committees can facilitate the failure of the budget process by simply slowing the system down until the time finally runs out. They are then free to fight for their own pet programs and projects on the last day, when Congress faces the necessity of passing a continuing resolution to keep government running. (P.S.: That is exactly the way the system worked before the budget reforms were enacted more than twelve years ago.)

Under the Gramm-Rudman-Hollings procedure, the incentives are going to be dramatically changed. If nobody does anything, automatic sequestration will inflict the pain of budget cuts without regard to seniority or committee status.

Does this story have a happy ending? I believe it does. Regardless of our rhetoric, the truth is that the federal government today only acts in response to a crisis. The one crisis we haven't been able to deal with is the crisis of deficit spending. Ironically, this probably is the most serious crisis of our time. I think our failure is caused by a kind of an institutional attention span problem. We do not seem to be able to focus on any event which does not begin and then come to a head within a

two-year election cycle.

What we have needed is a way to split up the problem of deficit spending into a series of smaller crises we can focus on. The greatest contribution of Gramm-Rudman-Hollings is that it does just that. It creates a set of regularly scheduled annual crises, each of which must be resolved within a one-year period, and it gives us and our constituents a set of baselines, so that everyone can keep score. This means we will no longer be able to base political campaigns on promises to balance the budget, while also promising more money for our constituents' pet programs, and also opposing taxes.

The great American philosopher, Casey Stengel, once said never make predictions -- particularly about the future. Defying Casey's rule, I predict that, despite the pain, Congress will move back to a standard of a balanced budget. The people of America may not understand all the esoteric aspects of the congressional budget process, but they instinctively know that the existing system is not working. They will support a simple understandable procedure that forces the hard choices which are necessary in setting budget priorities. These choices may result in the crisis of a tax increase, just as they may result in further crises of spending cuts. Facing those crises may be the most constructive step Congress can take.

CYRIL F. BRICKFIELD
American Association of Retired Persons

January 10, 1986

On behalf of the American Association of Retired Persons, I would like to say how pleased we are to attend Carol Cox's annual old-time gospel revival meeting on the deficit. —

Before I get into my remarks, I would like to reacquaint you with our Association. AARP now has over 20 million members, aged 50 and up. Not surprisingly, many of our older members have encouraged their post-50 children to join. Roughly 20% of our members are registered as Independent voters, while the remaining 80% are split almost evenly between the Democratic and Republican parties. About one-third work full or part time.

I come before you as the representative of this increasingly diverse, sophisticated, and aware group of older Americans.

Each fall, we survey a representative sample of our membership and our leadership about their opinions on the pressing policy issues facing the nation. The results of the most recent survey will guide AARP's National Legislative Council when they meet in Washington, D.C. later this month to consider the Association's federal and state legislative agenda for 1986.

Despite the remarkable diversity of AARP members' ages, political viewpoints, employment experiences, and geographic differences, the new survey reveals a strong common opinion: that the federal deficit is the nation's most serious economic problem.

The deficit is the chief economic concern of AARP members for a variety of reasons. Its threat to the economy could jeopardize the Social Security and Medicare trust funds, as happened during the late 1970's and early 1980's. A new round of inflation brought by the deficit could devastate retirees' pensions and savings. And many older Americans worry that the huge debt will be sloughed off onto their children and grandchildren.

These concerns formed the basis for AARP's support of responsible deficit reduction plans such as the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 and the Deficit Reduction Act of 1984. Both of these bills raised revenue and cut spending.

But, just as we want the deficit reduced, we are equally concerned about how it is reduced. In evaluating any deficit reduction package we will look--as we have in the past--at whether the package is both fair and effective.

Older Americans are not clamoring to be exempt from the pain of the deficit reduction, but they certainly are in no mood to volunteer when revenues are "off the table" and defense spending increases of 3 to 5%

after inflation are proposed.

Social Security is a case in point: here we have a program in which benefits will have been reduced by \$100 billion from 1981 through 1989, a program which is now financially sound, building a surplus and not adding to the deficit. Yet for many advocates of deficit reduction, it is the first program to which they point. This sets off an outcry and the bidding war on Social Security begins. While some may use that outcry to their advantage, the fact is, that the American public across all age groups, opposes reductions in Social Security by almost 9 to 1. A similar case can be made for Medicare and Medicaid. While a majority of the public favors deficit reduction, Social Security is the last option they would reach for. In fact, despite what you may read in some fashionable quarters, young people support Social Security. Indeed the much maligned payroll tax is viewed by all age groups as far more fair than our loophole riddled federal income tax.*

If Social Security is not driving the budget deficit, then what is? According to Congressional Budget Office estimates, legislative action from 1981 on could produce a cumulative deficit of almost \$1.5 trillion by the year 1990. Changes in federal spending and tax laws have brought about this dramatic change in federal fiscal policy.

On the tax side alone, tax cuts approved by Congress and signed into law by the President will increase the deficit between 1982 and 1990 by well over a trillion dollars. On the spending side, although cuts in domestic programs reduced the cumulative deficit by over half a trillion dollars, another \$400 billion was added back by defense spending. The effect of all this red ink and of rising interest costs on the national debt will add another \$400 billion to the cumulative of nine years. (Chart 1)

Both as a percentage of GNP and as a share of outlays, spending for national defense and interest costs are up, while spending for all domestic programs, including the so-called "uncontrollable entitlements", is down. Spending for entitlements, which was 44 percent of total outlays in the 1982 federal budget, is--according to the CBO--expected to drop to 38 percent of total outlays by 1990. Non-defense discretionary spending, at 19 percent of outlays in 1982, will drop to 15 percent in 1990. Conversely, outlays for defense spending as a percentage of total outlays will rise from 25 percent in 1982 to 30 percent by 1990. Interest on the national debt will also take up a larger share of the budget -- rising from 12 percent of total outlays in 1982 to 17 percent by 1990. (Chart 2)

Now we have a new law which is supposed to calm the fears of older Americans and others concerned about the deficit by balancing the budget in six steps, the Gramm-Rudman amendment. AARP views this plan as fundamentally flawed. It is a bull in a china shop approach to the nation's most serious problem.

As you may have gathered by now -- and as those of you who are involved in the budget know already -- we have, by necessity two views, each strongly held. But, despite their apparent divergence, we do not

view them as mutually exclusive. To bridge them however, requires a finely tuned package of spending and tax provisions. As simple as it may sound, mere "across the board" reductions are not workable. The sheer volume and complexity of the Gramm-Rudman amendment is ample testament to that.

Make no mistake, AARP is a special interest group; our job is to protect the interests of our members both short and long term. (In this regard, we view the continuation of Social Security and Medicare as social insurance programs as vital to the long term interest of older Americans -- indeed all Americans.)

We recognize, however, that if the deficit is to be placed on a declining path, there will be some pain for older Americans since a large portion (30%) of the budget is directed at them. In evaluating any deficit reduction package we will continue to look at whether it is both fair and effective.

TO BE FAIR, the package should recognize sacrifices already made, and since any package will not be painless, how that pain is distributed.

On this point, some now suggest that older Americans are, as a class, well-off and therefore can bear further burdens. Unfortunately, the facts don't support this comfortable assumption. Unquestionably, the economic status of older Americans has improved over the past two decades. We can all take pride in that.

Nonetheless:

- elderly household income is half that of the non-elderly; (Chart 3)
- social security beneficiaries are clustered at the lower end of the income scale, the same applies to Medicare; (Charts 4 & 5)
- older persons are paying a greater and greater share of their income for health care costs, (15% on average) not only due to rising costs under Medicare, but the 55% of their health care bill which Medicare doesn't cover. (Chart 6)

TO BE EFFECTIVE any deficit reduction plan must address those forces which are driving up the deficit: the rapid increase in defense spending and the huge drop in revenues brought about by the excesses of the 1981 tax cut.

Responsible action on the part of Congress to address the deficit would include: Number One: Applying the same scrutiny to defense spending as has been applied to non-defense spending, and thereby reducing the rate of growth; Number Two: Restoring the federal revenue base to a fiscally prudent level; and Number Three: Reducing the rate of growth in health care spending by better controlling costs.

With regard to revenues, the federal government provides subsidies on both spending and tax sides of the budget. Over the past few years,

the cutbacks have been primarily on the spending side while the loopholes and the giveaways have grown on the tax side. Simply put, you cannot ask Social Security beneficiaries to sacrifice a cost of living increase or absorb higher medical costs and not ask large corporations and wealthy individuals to do their part.

We cannot ignore the need for additional revenues if we want to reach the goal of a balanced budget by 1991.

Such revenues could come from increased tax compliance, elimination of inefficient tax expenditures such as the unlimited deductibility of interest on consumer credit and some major oil write-offs; increased excise taxes on cigarettes and alcohol; and restoration of an effective corporate tax.

AARP would not support, however, increased consumption taxes, such as sales taxes. The regressive nature of consumption taxes is magnified for older taxpayers, who generally spend money saved in previous years.

At times last year it appeared that a path out of the deficit might be in the making, but for one major reason: our nation's most famous older American, the President of the United States. And, we must be realistic, the same will likely apply this year, unless the President participates in crafting the deficit reduction package. Of course that probably means deeper domestic spending cuts than might otherwise be the case. The President drives a hard bargain.

On the other hand, some argue that we should simply resign ourselves and be content to see our political system produce an incomplete budget debate culminating in a Gramm-Rudman automatic spending cut next fall. After all, Medicaid, SSI, Social Security and several other programs are exempt and Medicare and other health programs are partly protected. But does anyone think that in one year \$25 billion can or should be cut from defense and another \$25 billion from domestic programs such as the Coast Guard, aid to education, elderly nutrition, the FBI, and so on?

In closing, let me say that we hope that the President and the Congress can agree on a budget which will be a product of our political system and not merely a default. All Americans regardless of age have a stake in finding a solution to the deficit. Eventually, we hope that we can work together to find a solution that no one will like but all can support.

Footnote:

- * Yankelovich, Skelly & White, A Fifty Year Report Card on the Social Security System, The Attitudes of the American Public, August, 1985.

CHART 1

INCREASE IN THE DEFICIT ATTRIBUTABLE TO CONGRESSIONAL POLICY ACTION

(Fiscal Years; Billions of Dollars)

TOTAL

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Legislative Changes									
Tax reductions	-41	-75	-99	-111	-130	-149	-162	-186	-228
Defense spending increases	-3	-16	-23	-35	-41	-53	-65	-79	-95
Nondefense spending cuts	40	48	50	38	63	69	73	82	88
Effect of legislative actions on interest costs	a/	-3	-10	-21	-35	-50	-69	-93	-123
Total changes	-5	-45	-81	-129	-143	-183	-223	-276	-359

-1181

-410

+551

-404

-1444

CHART 2
COMPOSITION OF OUTLAYS
IN THE FEDERAL BUDGET
(1982 and 1990)

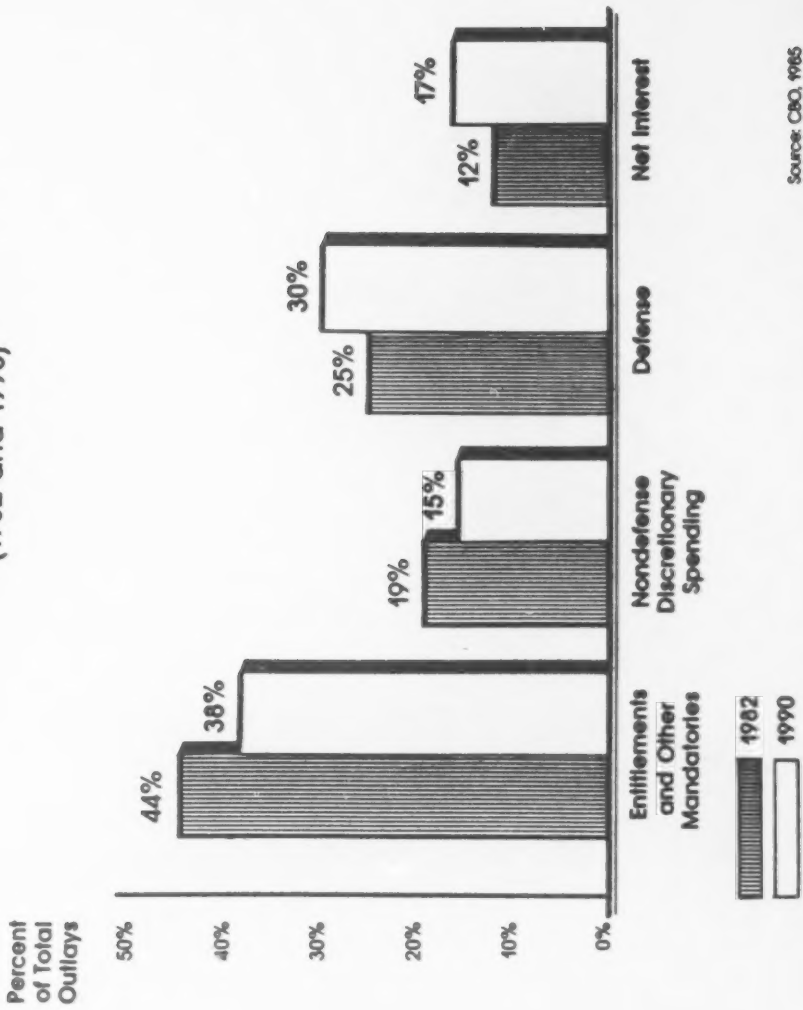
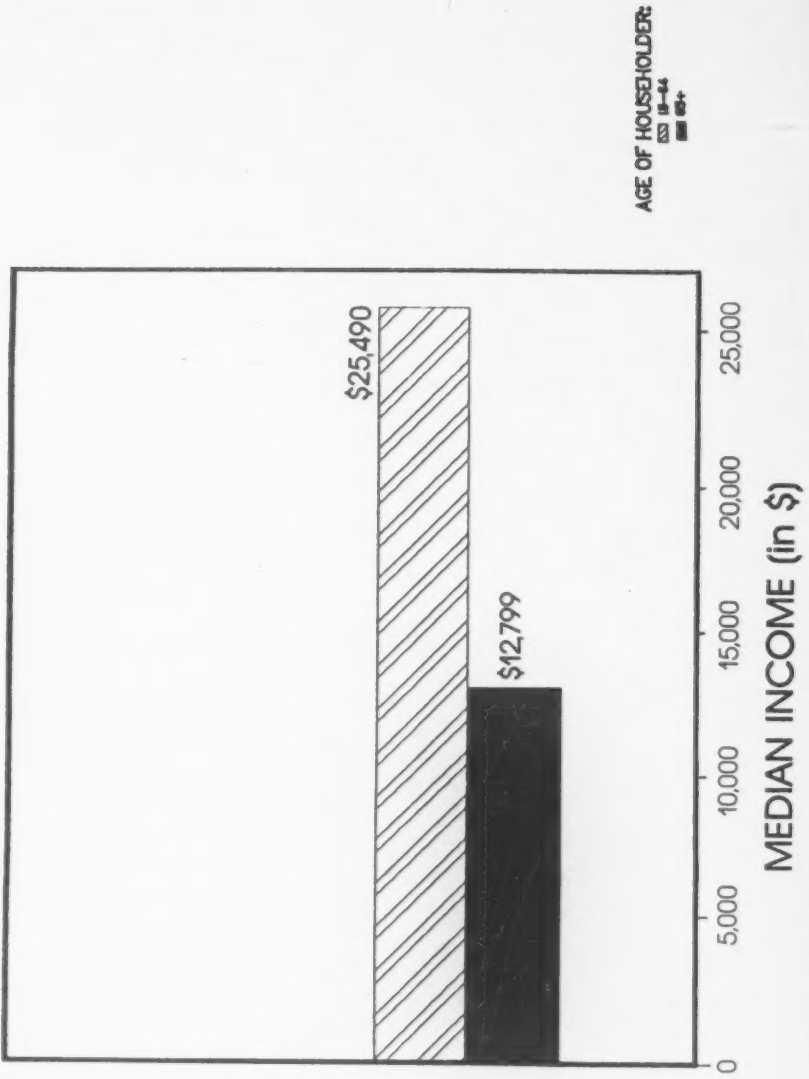
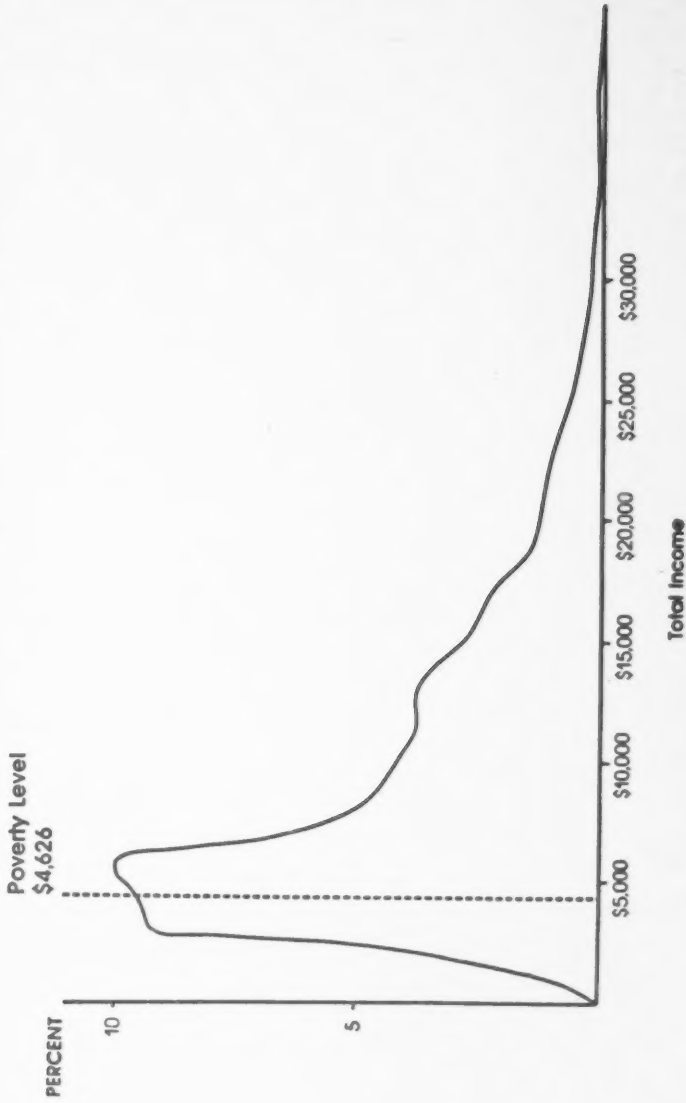


CHART 3
1984 HOUSEHOLD INCOME:
ELDERLY VS. NON-ELDERLY



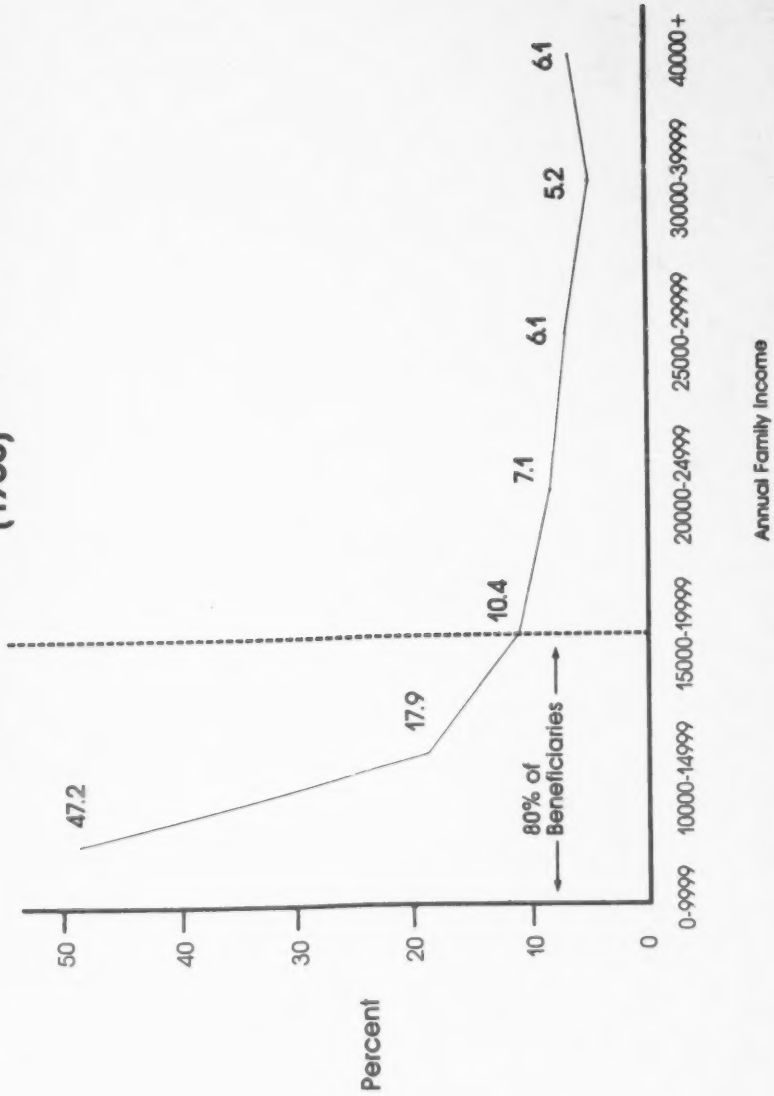
Source: U.S. Bureau of the Census

CHART 4
**DISTRIBUTION OF AGE 65 + SOCIAL SECURITY
 BENEFICIARIES BY TOTAL MONEY INCOME
 1982**



Source: Grad, Susan. *Income of the Population 55 and Over, 1982*. DHEW, SSA, March 1984, Table 13.

CHART 3
**PERCENT DISTRIBUTION OF MEDICARE PAYMENTS FOR
 NON-INSTITUTIONALIZED POPULATION 65 AND OVER
 (1980)**



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ANNUAL HEALTH CARE PAYMENTS MADE BY THE AGED

	Per Aged Person	Payments as a Percent of Income
1966 (Pre-Medicare)	\$300	15%
1977	\$698	12%
1981	\$1198	14%
1984	\$1550	15%
1989	\$2208	16%
1993	\$2892	17%
2000	\$4637	19%

STRUCTURAL DEFICITS: IMPLICATIONS FOR THE ECONOMY AND INDUSTRY

by

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Introduction

Since 1983, the economy has experienced fiscal deficits that are unprecedented by postwar standards, and unless the course of fiscal policy is substantially altered, there is a palpable risk that deficits of this magnitude will be in evidence through the end of the decade. After peaking at 7% of GNP in FY 1983, the aggregate Federal Deficit including off-budget categories has averaged over 5% of GNP, and CBO projections show the deficit fluctuating in the area of 4% of GNP during the remainder of the 1980s. While the initial rise in the deficit was due in part to the 1981-82 recession, the deficits projected for the late 1980s are distinctive in that they are structural rather than cyclical in origin. Expressed another way, the full-employment budget will exhibit structural deficits over the business cycle, a reversal of prior historical experience in which large deficits have typically been cyclical in origin.

The implications of this fiscal situation for manufacturing are substantial, but in the final analysis, they cannot be considered separately from the impact on the economy as a whole. Further, it must be borne in mind that the relationship between structural deficits and the performance of manufacturing is indirect. There is no one-for-one correspondence between a given change in public sector borrowing and the growth rate of manufacturing. Rather, the impact of the deficit depends critically on the way in which it is financed, its magnitude relative to private savings, and the degree to which its short-term income-expenditure effects are offset in the long run by more adverse outcomes such as high real interest rates and exchange rate appreciation.

The focus in this paper is primarily on the longer-term implications. In this respect, the projected deficits for the late 1980s are likely to have a destabilizing impact on the business cycle, and for this reason will create substantial problems of fiscal-monetary coordination. The misalignment of monetary and fiscal policy will contribute to keeping both long and short term interest rates high, through expectational and flow of funds channels. They will contribute to keeping the dollar exchange rate overvalued, primarily by encouraging reserve inflows. Finally, they create the potential for a return to a more destabilizing monetary policy, in the event that policy makers should decide to accommodate the deficit through reserve money creation. Although this is comparatively unlikely, the existence of this possibility has contributed to the emergence of high "expectations premia" on interest rates, thereby keeping long-term rates higher than they otherwise would be.

Part 2 briefly outlines some perspectives from macroeconomic theory on the likely consequences of large deficits. Part 3 presents a critical examination of the degree to which these are applicable in the contemporary policy context, with particular emphasis on the implications for manufacturing. Part 4 examines possible alternatives for reducing the deficit. Part 5 examines the issue of tax increases as a means of dealing with the deficit, and the more recent issue of tax reform.

Part 2: Perspectives From Macroeconomic Theory

Contemporary economic theory offers a range of perspectives on the effects of fiscal policy on the economy. While Keynesian macroeconomic theory has been comparatively unpopular in policy circles over the last few years, the Keynesian analysis of current fiscal issues may ultimately prove more accurate than competing views derived from certain strands of neo-classical economics.

Keynesian fiscal theory can be viewed as normative in that it incorporates specific recommendations as to the management of aggregate demand; in order to stabilize the business cycle, policy makers should actively lean against the prevailing cyclical direction in the economy.¹ Budget surpluses should be used during periods of rapid growth in order to prevent the economy from overheating, while deficits should be incurred during recessionary periods in order to counteract the decline in private sector activity and mitigate output losses. If policy makers consistently adopt Keynesian fiscal rules, the full employment budget will normally be in surplus, i.e., deficits will be solely the result of recessions, and will be eliminated during the ensuing recovery, translating into an approximate equilibrium between revenues and expenditures over the business cycle. In the event that permanent, structural deficits at full employment, emerge, however, Keynesian theory would tend to predict a destabilization of the business cycle: the increase in aggregate demand from the deficit will rapidly cause the economy to overheat, producing an acceleration in inflation. In order to avoid a continuously accelerating inflation rate, policy makers would eventually be forced to throw the economy into recession to slow price increases. The net effect would be that far from mitigating cyclical fluctuations, chronic structural deficits would inexorably exacerbate cyclical volatility.

Under the circumstances, it is perhaps somewhat ironic that the political legacy of Keynesianism has frequently been blamed for the emergence of chronic deficits.² In the United States, the deficits incurred in the name of demand management during the 1950s and 1960s were on the whole relatively small, while it is frequently overlooked that surpluses were periodically used as a disinflationary measure at this time. Conversely, the emergence of large structural deficits during the 1980s took place under an administration which putatively rejected demand management as a policy objective, but rather drew its policy programs from the ideas of economists who ostensibly repudiated Keynesian ideas.³ The existence of large deficits at full employment is in fact completely incommensurate with Keynesian demand management principles, and it is not accidental in this respect that prominent Keynesians have ranked among

this administration's most vocal critics.⁴

The same prediction -- that chronic deficits will produce cyclical instability coupled with rising inflation -- has also been voiced by the monetarist school, which has tended to disagree with the Keynesian camp on other issues. If there is an upper limit on the public's ability to absorb new issuances of Treasury bonds, chronic deficits will eventually have to be financed by borrowing from the central bank through reserve money creation, yielding faster monetary expansion and accelerating prices.⁵ The historical experience of fiscal-induced hyperinflations and of rampant inflations in Third World countries originating in secular fiscal imbalance has periodically been cited as indicative of the inflationary risks inherent in deficit spending. As the sequel will demonstrate, however, both in the United States and in the other industrial countries, the linkages between government borrowing and monetary aggregates have on the average become weaker since the emergence of large deficits. The result is that the implications of the deficit for the economy must be analyzed not in the context of monetary accommodation of fiscal impulses, but rather under circumstances of independent fiscal and monetary policies in which deficits are financed by borrowing from domestic and foreign private savings (in economic parlance "bond-financing").

Conventional Keynesian theory has tended to assume that fiscal impulses will be implicitly ratified by monetary policy, i.e., if the central bank pegs interest rates in accordance with Keynesian recommendations, an increase in public sector demand for credit will raise rates above targeted levels unless the central bank responds with greater infusions of liquidity. By comparison, if the central bank adopts quantitative targets for monetary aggregates, monetary policy will largely ignore the public sector borrowing requirement, with the result that larger deficits will be reflected primarily in higher interest rates. The ability of fiscal policy to stabilize the economy will here be weaker than if monetary and fiscal instruments are deliberately synchronized as part of overall demand management strategies. The monetarist school has even gone so far as to argue that bond-financed deficits have no impact on economic activity, and by implication that fiscal policy has no effect on aggregate demand independent of monetary policy. This thesis has been the subject of extensive debate among economists, much of it centered around the well-known St. Louis Federal Reserve model.⁶ The consensus appears to be that while fiscal policy is not inherently powerless as orthodox monetarists have claimed, the ability of fiscal deficits to stabilize aggregate demand is considerably greater when they are ratified by monetary policy than when monetary policy adopts an offsetting stance. Further, because monetary policy instruments are generally more powerful than fiscal instruments, in the event that chronic deficits are incurred, the potentially destabilizing impact can be mitigated by an offsetting monetary reaction.⁷

Given the above, the prediction of contemporary theory for the effect of bond-financed deficits on the economy is for an asymmetric impact on the business cycle. In the short-term, a bond-financed deficit yields an increase in economic activity through income-expenditure channels. Over a somewhat longer time horizon, however, greater pressure

in capital markets resulting from higher government borrowing coupled with higher private sector demand for credit caused by the pick-up in economic activity will produce higher interest rates. Interest rates will also rise in the event that greater demand pressure throughout the economy causes an increase in inflation. Eventually, the rise in interest rates causes a slowdown in the economy. In the long-term, the economy will converge back to its equilibrium growth path; fiscal policy will in this sense be limited to a transitory impact on the economy, and will be neutral in the long term. However, if deficits are sufficiently large or prolonged, their effect may be more adverse. A permanent increase in the deficit implies a corresponding permanent increase in interest rates. Once the temporary income-expenditure effects of the deficit are exhausted, the economy will diverge below its long-term potential growth rate. In this respect, permanent bond-financed deficits may actually be contractionary.⁸

In recent years, several other channels through which deficits may be contractionary have been suggested. Following an argument proposed by the Rational Expectations theorists, large deficits may raise interest rates by raising inflation expectations.⁹ If financial decision makers anticipate that deficits may be monetized, they will exact higher risk premia on loans in an effort mitigate the threat of devaluation of their real rates of return by inflation. Thus long-term interest rates which are heavily influenced by expectations may be raised above the levels implied solely by greater public sector participation in credit markets.

A second contractionary effect may emerge in the event that deficits are financed by foreign borrowing. In a fixed exchange rate regime, foreign borrowing will simply produce reserve inflows through the balance of payments and greater domestic liquidity. However, in a flexible exchange rate environment, foreign borrowing will be reflected in a real appreciation of the exchange rate and a loss in trade competitiveness. The loss in export opportunities coupled with greater import penetration will further depress real economic activity; GNP will decline through the channel of net exports.

If the magnitude of these effects is sufficiently large, it is possible for a vicious cycle to develop. Large bond-financed deficits will slow the economy after an initial surge in activity through the high interest rate and loss of competitiveness mechanisms discussed above. Normally, the economy could be expected to equilibrate itself inasmuch as slower growth would lower interest rates and reduce demand for imports, creating the preconditions for an eventual recovery. However, if the growth-slowdown is sufficient, the deficit will be widened due to inadequate growth in tax revenues. The larger public sector borrowing requirement will in turn keep interest rates high and the exchange rate overvalued, thereby depressing the growth rate. In this way, slow growth and large deficits will systematically reinforce each other in a pattern of circular and cumulative causation. Expressed another way, a permanent structural deficit and the resulting permanently higher level of interest rates will keep the economy permanently below its potential growth path.

Part 3: The Experience of the American Economy

The foregoing suggests several possible outcomes resulting from large fiscal deficits, chronic inflationary tendencies due to fiscal pressure on the money supply, a destabilization of the business cycle characterized by violent fluctuations in real economic activity, high real interest rates, losses in competitiveness, and long-term stagnation. In order to evaluate the actual impact of the deficits, it may be useful to examine each of these possibilities individually.

1. Deficits, Money Creation and Inflation

The view of the deficits as inflationary may immediately be dismissed. Since October 1979, the Federal Reserve has operated primarily by specifying quantitative target ranges for the monetary aggregates, and has set these targets independently of the Treasury's borrowing needs. Despite the strongly expansionary thrust of fiscal policy, monetary policy has on the whole concentrated on achieving disinflationary policy objectives, even to the extent of leaning against the stance of fiscal policy and deliberately slowing the economy. Moreover, the brief phase of monetary reflation from mid-1982 to mid-1983 was not impelled to any substantial degree by fiscal pressures; rather, it was motivated more by the Third World debt crisis, the unexpected depth of the 1981-82 recession, and the equally unanticipated decline in monetary velocity. The same types of factors, particularly the phenomenon of unusually low velocity growth have impelled the more recent loosening of monetary policy in 1985, and it is significant in this respect that the Federal Reserve has loosened only when it became apparent that inflation was under control. Econometric tests also support this prognosis. Estimation of monetary reaction functions for the post war era reveal a significant positive relationship between the fiscal deficit and the money supply only up to the mid-1970s. Thereafter, this relationship vanishes, and if similar tests are run for the period of quantitative targeting from 1979 onward, a negative relationship is in evidence.¹⁰ Judging by the actual behavior of the inflation rate, the Federal Reserve's disinflationary strategy has been eminently successful. While inflation as measured by the GNP deflator surpasses 9% per year in 1980-81, it had been cut to the 4% range by 1983, and throughout the current recovery price movements have continued to remain moderate. The fears voiced with considerable frequency in the early 1980s that the projected deficits would generate accelerating inflation have now been conclusively demonstrated to be unjustified.

Interestingly enough, the emergence of an arynchronous relationship between fiscal and monetary policy antecedes the current fiscal situation. During the recoveries of 1971-73 and 1975-79, the Federal deficit declined on average; at the peak of the business cycle, in 1973 and 1979 when the inflation rate underwent a sharp acceleration, the deficit declined to 1.2% and

1.7% of GNP, respectively. By comparison, during the disinflationary period 1975-76 when monetary conditions were restrictive, the deficit expanded to a peak of 4.5% of GNP. The prognosis is that the relationship between deficits and money creation at this time was considerably weaker than has sometimes been argued. The implication is that the rise in inflation during the 1970s was not a result of fiscal pressure. In general, the evidence from numerous studies support the conclusion that when the central bank adopts a policy of annual quantitative targets for the money supply, the relationship between fiscal and monetary indicators tends to be negative or negligible. From the mid-1970s onward, larger fiscal deficits were in evidence throughout the advanced industrial economies, but monetary policies on the whole followed more disinflationary objectives, with the result that the larger public sector borrowing requirement was not financed by money creation.¹¹

The emergence of a negative fiscal-monetary relationship since 1979 should not of course be taken to mean that the stance of fiscal policy is not destabilizing. Rather, it means that the Federal Reserve has been obliged to hold to relatively restrictive targets for monetary aggregates in order to prevent an acceleration in inflation from taking place. In this case, the large deficits have created substantial problems of fiscal-monetary coordination.

2. Business Cycle Instability

The over-expansionary stance of fiscal policy appears to have had an adverse impact on the current recovery, although not in the same manner as during the last three business cycles. Historically, the impact of fiscal policy on the business cycle has tended to be destabilizing roughly from the mid-1960s onward. During the early 1960s when the full employment budget was in balance, the economy converged to its equilibrium growth trajectory with a stable non-accelerating inflation rate in the 1% range. However, beginning with the Vietnam War buildup of the late 1960s and continuing through the following decade and a half, the full employment budget exhibited chronic disequilibrium. During relatively late stages in the business cycle when fiscal policy should have become restrictive in order to prevent the economy from overheating, the stance of fiscal policy remained consistently over-expansionist; the large full employment deficits recorded in 1968, 1972 and 1977-78 are cases in point. The net outcome was the overheating of the economy during the booms of the late 1960s and the early 1970s onward in which the economy underwent successive cycles of reflationary growth followed by deep recessions.

The sequence of events during the 1983-85 recovery has been somewhat different. The recovery consisted of a five-quarter

boom in 1983:2, through 1984:2, followed by a period of sluggish growth thereafter, with little indication of any likely return to faster economic expansion. During the five quarter period of rapid expansion, the growth rate of GNP averaged 7.8%. Since this time, however, GNP has expanded by an average of roughly 2%. The slight pickup in economic activity in late 1985 was unspectacular, with growth rising only to the 3% range, and does not by any means signal an interruption of the slow growth pattern. Similarly, during the period from March 1983 to July 1984, the index of industrial production rose by a cumulative total of 18.5%. However, from August 1984 to August 1985, the increase in industrial production was only 1%. During the same period, the capacity utilization rate in manufacturing fell from 81.8% to 80.2%, while capacity utilization in industrial materials dropped even more drastically from 83.1% to 79.8%. In this respect, the slowdown in economic activity that has characterized the latter part of this business cycle has been particularly serious in manufacturing.

There are several reasons for this. First, manufacturing and goods-producing industries in general are more vulnerable to inventory cycles. Although inventories were drawn down during the early stages of the recovery, in early 1984 a return to accumulation took place, bringing the inventory-sales ratio from a postwar low of 1.29 in January to 1.38 by the summer. At this juncture, however, business had apparently misgauged the extent of the slowdown in demand, leading to the emergence of an overhang of unsold stocks. Excess inventories were not substantially liquidated until late 1985, which accounts in part for the slowdown in manufacturing production.

A second factor has to do with the fact that goods-producing sectors are considerably more vulnerable to import penetration. As discussed in more detail below, a significant component of the slowdown in economic activity has been due to the decline in net exports, both as a result of sluggish growth in American exports overseas but more importantly because of massive increases imports of manufactures. The trade deficits that have characterized the 1983-85 recovery are distinctive inasmuch as unlike the OPEC-induced trade deficits of the 1970s, they have been concentrated in manufactured goods rather than petroleum. The implications for the business cycle are serious. During the last two major periods of expansion, 1971-73 and 1975-79, the pace of economic activity during the latter stages of the business cycle was sustained in part by major export booms, which were particularly marked following the devaluations of 1973 and 1978. By comparison, the fact that the exchange rate tended to appreciate on average until early 1985 meant that no export-led growth took place. Instead, the external sector worked in the opposite direction, depressing the growth rate of the economy from mid-1984 onward.

A third factor, which has been somewhat less significant, is

manufacturing industries, both the growth rate of capital investment and the level of consumer demand are critically dependent on the cost and availability of long-term credit. From mid-1984 onward, both aggregate consumer activity and business fixed investment have slowed on average, although this must be qualified by the fact that the slowdowns were limited to particular quarters. If the individual weak quarters are factored out, both consumer spending and capital investment have held up remarkably well during the period of slower economic growth. The cost, however, has been that both business and consumers have leveraged themselves to potentially unsustainable levels in order to maintain the growth of spending. As of the third quarter of 1985, personal savings had been drawn down to a postwar low of less than 3% of disposable income, while consumer installment debt stood at roughly 18% of disposable income, a postwar record. Although business cash flow relative to debt service recovered from its depressed levels of the 1981-82 recession, corporate debt-equity ratios in 1985 were scarcely below their levels of 1983, indicating that business has by and large been willing to incur atypically high levels of debt. High levels of personal and corporate leveraging in turn imply an upper limit on the ability of domestic demand to sustain economic activity. At some point, the inability to incur additional debt and the need to reliquify could further slow the economy; even if a recession does not emerge during the next two years, high degrees of leveraging will militate against a return to rapid gains in economic activity.

While the proximate causes of slower growth have been due to the inventory cycle, the trade deficit and high interest rates, the indirect causes are closely bound up with the fiscal deficit. In this respect, the transition from rapid expansion to sluggishness in 1985 seems fully commensurate with the scenario outlined above in which bond-financed deficits generate an initial surge in economic activity followed by a compensatory downturn. There is also increasing evidence that the United States may be caught in the kind of vicious cycle described earlier, in which deficits and slow growth perpetuate each other. CBO estimates projecting deficits in the range of 4% of GNP through the end of the decade are predicated on relatively favorable economic assumptions. A somewhat weaker economic performance, for instance in the event of a recession in 1987 or 1988, would raise the deficit above even these projected levels, and further aggravate a fiscal situation that already gives indications of near-intractability.

3. Deficits and Interest Rates

The effects of the deficit on interest rates can be gauged through a brief overview of the behavior of short and long term rates since 1983. Short term interest rates, which are determined mainly by market forces, have been raised primarily

through flow of funds mechanisms.

One indicator of the degree of pressure in credit markets is provided by the ratio of Federal borrowing to all funds raised, excluding equities. This ratio, which stood at only 19.1% in 1979, surpassed 34% in 1980-81, reaching 49.7% in FY 1982 and 56% in FY 1983. While initial estimates show this ratio falling 36.6% in FY 1984, the degree of "crowding out" in credit markets due to the fiscal deficit has been unprecedented by postwar standards.¹² The effects on short term interest rates are manifest. Econometric simulations indicate that short term rates since 1981 have been significantly higher than can be accounted for by their prior behavior.¹³ The real short term interest rate in the Fisherian sense of nominal rates less inflation expectations is not directly observable, but the real ex-ante rate of return as measured by nominal rates less actual inflation has been at unprecedented levels. In 1983 and 1984, the real ex-ante prime rate stood at 7% and 8.2% respectively. The corresponding figures for the Federal funds rate are 5.3% and 6.4%.

With respect to long-term rates, levels appear to have been influenced both by pressure in credit markets and by inflation expectations. Econometric tests indicate that the level of long-term rates has been even higher than can be explained solely by the level of short term rates, suggesting that fear of inflation due in large measure to the deficit has led to higher risk premia being built into rates on long-term loans. This in itself supports the Rational Expectations hypothesis cited earlier that large fiscal deficits may raise interest rates through expectational channels. The real ex-ante long-term rate of return on long-term government bonds stood at 7.5% in 1983 and 8.6% in 1984. The corresponding figures for fixed-rate 30-year mortgages are 8.7% and 8.5%. These are the highest real rates of return witnessed since the Great Depression of the 1930s.

While some commentators have argued that the deficit is not fundamentally responsible for the level of real rates since 1981, primarily on the grounds that there is no long run correlation between interest rates and deficits, this argument does not hold up under careful scrutiny. There was no long run relationship between deficits and the variance of interest rates prior to 1979 for two major reasons. First, deficits tended to behave countercyclically, rising during recessions and falling during recoveries. This meant that the Federal government's demand for credit correlated inversely with that of the private sector. Secondly monetary policy normally pegged interest rates at levels that were commensurate with broad accommodation of the Federal borrowing requirement. However, because of the change in Federal Reserve operating procedure in October 1979, prior historical evidence is now substantially irrelevant to the issue of whether deficits have policies which

raised short term rates. Further, while the crowding out process described above does not account for the variance of interest rates over the last few years, nevertheless it provides a powerful explanation for the average level of real rates of return. In the final analysis, therefore, the overly expansionist fiscal stance in conjunction with monetary policies which have remained essentially anti-inflationary goes quite far in explaining the level of long and short term rates over the past few years.

4. The Misalignment in Exchange Rates

The current mix of tight monetary and loose fiscal policy is the single most important factor responsible for the appreciation of the dollar since 1981. The rise in U.S. interest rates and the resulting differential in real rates of return vis-a-vis other countries have led to increased world demand for dollars to purchase dollar-denominated financial assets. A related if secondary factor has been the increased volume of U.S. government debt instruments issued in global financial markets. To the extent that the large deficits projected for the balance of the decade cannot be financed by domestic borrowing, they will be financed through continued reserve inflows, thereby keeping the dollar overvalued. The extent of the appreciation of the dollar has also been unprecedented. Using the IMF's multilateral trade-weighted index, the dollar appreciated by more than 60% between its trough in late 1980 and its peak in early 1985. Since this time, in the wake of massive intervention in global currency markets by the Federal Reserve and foreign central banks, the dollar has depreciated by about 18%. However, this still leaves it overvalued relative to purchasing power parity by 30% or more.

The effects on the trade balance in manufactures have been nearly disastrous. Tables 1 and 2 provide selected indicators of the decline in competitiveness since 1980. Table 1 gives exports and imports as a share of domestic production and consumption, respectively, for selected industries. Since 1981, exports have fallen sharply as a share of production, particularly in instruments, aerospace, machine tools, and even in high-technology in which the United States enjoys a comparative advantage. During the same period, imports as a share of domestic consumption have surged, with particularly marked increases in certain consumer non-durables, general industrial machinery, machine tools and even in computers and semi-conductors. Table 2 gives the trade deficit by sector. In 1984, the United States ran a massive trade deficit in manufactured goods. The trade accounts were in deficit in almost every category of manufacturing.

A major adverse result of the overvalued dollar that has not been accorded sufficient attention in the United States is the

degree to which it has been directly responsible for the global nature of the 1981-82 recession. Here several causal mechanisms are involved. The interest rate differential between the United States and the other industrial countries has generated reserve flows, undercutting the balance of payments of foreign nations. At the same time, because the bulk of global trade is denominated in dollars, the appreciation of the dollar has raised import prices abroad, creating a severe problem of "imported inflation" in trade-dependent economies. Because of reserve outflows and the rise in import prices, the other industrial countries have been forced to apply restrictive policies in order to mitigate the interest rate differential with the United States, support their balance of payments, and prevent any further depreciation of their exchange rates against the dollar. In this regard, they had very little choice. Countries that attempted to reflate experienced massive balance of payments deficits and devaluation crises, followed by mounting inflation due to the feed-through of import costs into domestic wage-price cycles. While restrictive demand management policies overseas prevented this from taking place, the cost was that the economies of the other industrial countries have remained chronically recessed.¹⁴

This in turn has further undermined the American trade balance. Because demand overseas has been recessed, the market for American exports has been proportionately weaker. Similarly, inasmuch as foreign industrialists have encountered slack in domestic markets, they have responded by shifting to export markets, frequently in the United States. In this manner, the appreciation of the dollar has been responsible for the trade deficit not only through its direct effects on competitiveness, but also through its indirect effects on relative business cycles across national boundaries.

Part 4: Toward A More Appropriate Fiscal Policy

1. The Economic Implications of Fiscal Restraint

Given the above, the most essential priority for Congress in the area of fiscal policy over the next few years is the development of a budgetary program more commensurate with macroeconomic stability. This should consist of a major reduction in deficits achieved primarily through phased cuts in outlays. Such a policy would have a series of beneficial effects on the economy.

First, reductions in outlays will mitigate the current over-expansionary stance of fiscal policy and lower the risk of destabilizing the business cycle. In this manner, it will be possible to bring the economy closer to its long-term equilibrium growth trajectory. In essence, a less stimulative fiscal posture will eliminate the current adverse range of choice between allowing the economy to overheat as it

has during prior recoveries, or forcing interest rates to rise through non-accommodation of the fiscal stimulus.

Second, reductions in spending will facilitate a more permanent reduction in interest rates. This will take place through two channels. The reduction in aggregate demand resulting from spending cuts will lead to slower credit demand, and at the same time, lower Federal credit needs will mitigate the crowding out problem in capital markets. The lower deficit should also reassure financial decision makers that there is no further danger of an acceleration in inflation, which should lower the expectations premium on loans, permitting some reduction in long-term rates. In addition, reductions in both interest rates and the volume of Treasury securities issued in global financial markets will help to achieve a more realistic exchange rate for the dollar. This will generate an improvement in trade competitiveness, leading ultimately to higher employment. At the same time it will alleviate the balance of payments constraint on demand management in the other industrial countries, enabling them to pursue more expansionary policies, stimulating faster worldwide economic growth.

It should not be surmised of course that these benefits would necessarily emerge in the short run, or that a policy of systematic fiscal restraint would not involve substantial adjustment costs. Given the evidence that the near-term effects of fiscal policy on the economy take place primarily through income-expenditure channels, the immediate effects of fiscal restriction would in all likelihood consist of a downturn in economic activity. This, however, would be temporary, and over the medium term the economy would return to or surpass its equilibrium growth trajectory. In the long run, the performance of the economy would undoubtedly be enhanced with the full-employment budget in surplus. In essence, the effects of fiscal restraint, like those of fiscal expansion, are likely to be asymmetric. In this respect, the difficulty in achieving fiscal restraint stems in part from a political unwillingness to incur the short-term costs. Consequently, in order to make a policy of fiscal restraint politically viable, a series of procedural improvements to the budgetary process should be enacted with a view to strengthening the ability to enforce fiscal targets.

2. Improvements in Fiscal Policy Targets

Controlling deficits will require greater adherence to fiscal policy rules. Among possible rules that are applicable in the conduct of fiscal policy, one concept originating in Keynesian stabilization theory that would provide a more stable budgetary posture has to do with targeting the full employment (or standardized employment) deficit. More specifically, Congress should bring the full employment budget into surplus over the

next business cycle, and hold it in surplus permanently thereafter. By maintaining the full employment budget in surplus, the asymmetry between fiscal and monetary policy would be substantially reduced. Further, reduction of the deficit to a level commensurate with a permanent surplus at full employment would leave the stance of fiscal policy more compatible with stable economic growth. With the full employment budget in surplus, the actual budget would be in approximate equilibrium over the business cycles: surpluses would occur during periods of high growth, and would effectively offset deficits incurred during recessions. Rather than attempt to achieve this in a single year, however, it would be more desirable to achieve the full employment budget surplus more gradually, for instance, over a period of five to seven years.

Of the existing attempts to adopt fixed rules for fiscal policy, a promising approach is the Gramm-Rudman-Hollings proposal of phasing in budget cuts over a period of several years, which is sufficiently flexible that the adjustment costs would not necessarily be prohibitive.

3. Deficit Reduction Techniques

The primary strategy for lowering Federal deficits must emphasize across-the-board reductions in the growth rate of Federal spending. Such reductions should be spread as evenly as practicable over all portions of the Federal budget, including Social Security, and defense spending. To hold certain segments immune from reductions will jeopardize the entire fiscal control process. While the following list is by no means exhaustive, it provides several options which are worthy of consideration.

- (1) Curtailment of Entitlement Spending. Although the growth of transfer payments now appears to be in the process of leveling off and outlays for income transfers may undergo a modest decline over the next several fiscal years, nevertheless, the existing transfers will continue to work against efforts to reduce the deficit. For this reason greater control over income transfers is required. At the very least, no new entitlement programs should be created. Preferably, given the pressure on outlays exerted by indexation, all existing indexed income transfer programs, including Social Security, should be indexed to something less than 100% of CPI increases. Here there seem to be two major options, either reducing the indexing formula by a specified number of percentage points (e.g., CPI increase minus 3%) or holding the index to a percentage of CPI increase (e.g., 60% of CPI). Both approaches would produce major savings.
- (2) Freeze Proposals. There are compelling political as well

as economic grounds for the concept of freezing Federal spending at current levels (or at current levels plus a modest growth increment). An enforceable overall freeze may be one of the few techniques for imposing the across-the-board sacrifices that is sufficiently equitable that it would not be subject to the critique of unjustly penalizing certain groups at the expense of others. A possible variation of this technique would be the adoption of mandatory spending targets which would specify reductions in Federal outlays over a given number of out-years. The Gramm-Rudman-Hollings proposal to require specified spending reductions aimed at eliminating the deficit by 1991, which is pending before Congress as of the time of this writing, (11/1985) is an example of this type of solution.

- (3) Limits on Federal Credit Activity. Binding limits should be established for all Federal credit activity. Such limits should be enforced through the authorizations and appropriations process, primarily through dollar limitations. Funds for credit activities should also be subject to the same impoundment and reconciliation procedures that are mandated in the Congressional Budget Act for other types of activity. In other words, an equivalent degree of control should be exercised over both direct spending and credit programs.
- (4) Procedural Improvements. The Congressional budgeting process needs to be strengthened further in order to achieve the fiscal discipline needed to reduce deficits. In order to maintain the integrity of the budget process, enforcement mechanisms such as reconciliation should be improved. The first concurrent resolution should be made binding, while the second concurrent resolution can be eliminated. In addition, Congress should have the option of attaching reconciliation instructions to concurrent budget resolutions. The current statutory ten-day limit for Congress to complete action on a reconciliation bill is insufficient and should be altered. The Budget Committees and Congress should codify the option to include provisions for reducing spending on transfer payments and discretionary items in reconciliation instructions. Finally, the amount of savings achieved in reconciliation bills should be measured on the same basis used by the budget resolution which required them. A final recommendation is that any future deficit reduction package must be structured so that, on a year-by-year basis, no planned tax increase will go into effect until there has been an objective certification (perhaps by the CBO) that planned spending cuts of a greater magnitude than the tax increases have actually occurred.

Part 5: Tax Policy Issues and the Deficit

1. The Issue of Tax Increases

At the current time, public policy circles are sharply divided

on the issue of how the deficit is to be eliminated. The administration has held out against tax increases, without however proposing the spending cuts that would be necessary to lower the deficit; elements of the Congress have argued that the structural imbalance between revenues and expenditures will eventually require a tax increase. Professional economists remain equally divided. Without wishing to deal extensively with this debate, there are compelling reasons why tax increases should be considered only as a last resort, or at the very least only in conjunction with concomitant spending reductions. Perhaps one of the most significant innovations in economic theory over the last few years has been the detailed estimation of tax rates as a determinant of economic activity independent from the effect of fiscal policy. In this respect, it is now generally understood that tax increases may slow the growth of the economy above and beyond the slowdown that would normally be expected from the income-expenditure effects of the budget, through such channels as increases in the user cost of capital and decreased liquidity. Because tax increases tend to exert an immediate contractionary effect on economic activity, the timing of tax increases over the business cycle is of critical importance to their effects on the economy. If taxes are raised during a period of recession or slow growth, they will tend to produce greater economic slack and perpetuate higher unemployment. In the event that taxes were to be raised this year but the increases were not to take effect until future years, this would require acutely accurate foresight on the part of Congress as to the probable condition of the economy at the time the increases are scheduled to go into effect. Under the circumstances, Congress should defer consideration of any major revenue bills until such time as it appears the economy can sustain such an increase.

Investment in particular would be likely to suffer as a result of a major tax increase. Throughout the 1970s, businesses were excessively taxed as a result of two factors: the understatement of depreciation costs under ADR, and the overstatement of inventory profits due to inflation.¹⁵ While the Economic Recovery Tax Act of 1981 (ERTA) provided a more realistic system of capital recovery allowances, the tax increases enacted in 1982 and 1984 cut back substantially on these important business investment incentives, which should not further be eroded. A further argument against enacting tax increases now is that this would represent only a temporary expedient, rather than a systematic reform of the tax system. In the event that Congress enacts legislation substantially altering the tax laws, such a bill should address deficiencies in current tax law on a systematic basis, and should produce a more efficient tax structure that is more commensurate with stable economic growth.

2. The Tax Reform Issue

The issue of systematic tax reform has assumed increasing

prominence since the publication of two proposals by the Treasury in November 1984 and May 1985, (hereafter Treasury I and II respectively) with the President formally endorsing the second. In the wake of the administration's initiatives, a third tax reform proposal was reported out of the House Ways and Means Committee in late 1985. Taken at face value, tax reform does not relate directly to the deficit issue, since the Treasury and House Ways and Means proposals are ostensibly revenue neutral. This claim must of course be taken with the caveat that the second Treasury plan would by its own admission lose revenue with respect to current law. Nevertheless, because of the importance of the tax reform issue to manufacturing industries, some consideration of tax simplification is clearly warranted in this context.

The fundamental thrust of the Treasury and House Ways and Means proposals was to lower personal and corporate tax rates across the board, while making up the revenue by removing implicit subsidies in the form of credits, deductions and exemptions from the tax code. The net result, however, was that in both proposals the major targeted provisions for capital formation in current tax law -- principally the investment tax credit and accelerated depreciation -- were repealed, thereby substantially shifting the tax burden away from individuals and onto corporations. The magnitude of the increase in corporate taxation under Treasury I was approximately \$200 billion over five years, with longer-term estimates showing an increase of \$400 billion (in current dollars) over the first decade following passage. The second Treasury proposal was only moderately less onerous, with corporate taxes being raised by roughly \$120 billion over five years. The House Ways and Means proposal was similar in certain respects to that of the Treasury inasmuch as it would delete the ITC and ACRS, while actually lowering corporate rates by a lesser magnitude than either of the administration proposals.

The rationale cited by the Treasury for this massive redistribution of tax liabilities onto the corporate sector was that overall economic activity would be raised sufficiently by the cut in personal tax rates to compensate for higher taxation of business. However, the evidence on this point is problematical at best. The relationship between marginal personal tax rates and aggregate economic activity invoked by the Treasury is at best undemonstrated and probably negligible. The best econometric evidence on the effects of the Treasury proposals on the economy that we have so far had access to is provided in a study by Wharton Econometrics. The Wharton U.S. annual model was simulated for a period of ten years, incorporating the policy changes proposed in Treasury I and holding the other policy assumptions constant. The major conclusions of the Wharton simulations were as follows:

First, the shift in the burden of tax liabilities toward corporations, the loss of the ITC and the mitigation of

depreciation benefits all produce a sharp increase in the user cost of capital. Under Treasury I, the rise in the user cost was in the area of 25% to 30%. The rise in the user cost of capital generates a sharp fall in capital formation relative to current law. Business fixed investment was found to be about 5% lower by the end of the simulation.

Second, the economy becomes more labor-intensive. Because of the increase in the user cost of capital, business substitutes into labor. For this reason, employment rises relative to current law. Because of the decrease in capital formation and the increased substitution into labor, the capital-labor ratio falls relative to the baseline. This generates a corresponding fall in productivity growth.

The combination of higher employment, which yields higher wage increases, and lower productivity, which raises unit labor costs, translates into a higher rate of inflation. The higher inflation rate leads to higher interest rates. The combination of higher interest rates and higher inflation raises the Federal deficit through the channels of debt service payments and indexation of income transfers.

The output mix is shifted away from investment and in favor of consumption. On a sector-by-sector basis, real output falls relative to current law in manufacturing, durable goods, and capital equipment. Real output is somewhat higher in other areas, primarily in services and non-manufacturing sectors. The net effect is that the sectoral mix of output shifts away from manufacturing; in essence, Treasury I produced tendencies toward "deindustrialization."

Interestingly enough, Treasury I was found to be neutral with respect to real GNP. Nominal GNP was substantially higher than current law, but only because of higher inflation. Real GNP was essentially the same under current law and Treasury I. What changed only was the components of GNP. On the supply side, a greater share of economic activity was comprised by non-manufacturing activity while a greater share of factor inputs to production consisted of addition of labor.

The macroeconomic implications of Treasury II are generally similar to Treasury I inasmuch as the underlying thrust of both proposals toward corporate taxes is essentially comparable. Differences between the two are more likely to be differences in magnitude than in the overall effects on the economy. The economy would exhibit lower productivity, shifts toward labor inputs, shifts in the output mix toward services, higher underlying rate of inflation and a deterioration in industrial activity relative to trend. Capital-intensive manufacturing industries would experience an increase in their tax rates and their user cost. Non capital-intensive industries would do better, as would services and domestic trade. The external balance would probably deteriorate due to

higher consumption, which will be reflected in further increases in imports.

Other studies have reached comparable conclusions. Lawrence Meyer and Associates conducted econometric studies on the Treasury I and II plans, using the Washington University model. Their conclusion was that the user cost of capital would be raised by approximately two percentage points over current levels, an increase of 13% to 15%, depending on the sector of the economy and the rate of inflation. The major culprits here are unfavorable depreciation changes and the loss of the ITC.

If the economic implications of the Treasury proposals would therefore be largely unfavorable, the effects of the House Ways and Means alternative would be substantially more adverse. The Ways and Means proposal was subjected to econometric simulations by Lawrence Meyer and Associates, and the results were compared to CBO baseline forecasts for the economy. The outcomes were striking.

Assuming that the Federal Reserve holds the growth rate of non-borrowed reserves unchanged, GNP growth falls below the baseline by magnitudes of up to -0.7 percent per year. This contrasts with the results of Treasury I, which changed the output mix, but did not lower GNP itself. The overall level of business fixed investment was lower by magnitudes of up to -2.5% annually. The sharpest declines are witnessed in producer durables, but corresponding declines are also visible in residential structures and factories. Exports also fall relative to the baseline, reflecting the loss in competitiveness caused by the diminution of investment incentives. The unemployment rate is raised by the slower growth rate. By 1991, the jobless rate is 1.3 percentage points higher than in the baseline.

In sum, all other things being equal, the Ways and Means Committee proposal would produce net losses in output as well as accelerating the decline of heavy industrial sectors. It is possible, of course, for the negative effects of the tax revisions to be partially offset by a more reflationary monetary policy. As a supplement to the main simulation of the Ways and Means plan, Lawrence Meyer and Associates ran an additional simulation in which the Federal Reserve attempts to offset the decline in economic activity. With a substantially more expansionary monetary policy, it is possible to reach the same GNP growth rates as in the CBO baseline. However, as in the earlier Wharton simulations, the output mix is shifted away from industry and toward services, while the investment share of economic activity falls relative to consumption. Therefore, even offsetting actions by the Federal Reserve do not alter the basic prognosis that the Ways and Means proposal would engender a process of serious deindustrialization.

In sum, the tax simplification proposals have highly adverse implications for manufacturing. To the degree that some form of tax simplification will eventually be considered in Congress, new proposals should be developed which will produce a tax structure more commensurate with industrial prosperity, rather than the deindustrialization that would result from the existing plans.

Conclusions

The current stance of fiscal policy, in particular the large structural deficits that are projected to persist for the remainder of the decade, are not commensurate with macroeconomic stability; further, their impact will be particularly deleterious to manufacturing industries that are sensitive to high interest rates and vulnerable to import penetration. Recent initiatives to simplify the tax code, however, will merely compound the current difficulties of manufacturing by raising industry's effective tax liabilities, while failing to reduce the deficit. Instead, what is needed is a systematic plan to bring the deficit down to levels that will insure lower interest rates, a more realistic exchange rate and a stable business cycle. The adoption of fiscal targets commensurate with these objectives, for instance by bringing the budget into surplus at full employment, could go a long way toward setting the stage for future industrial prosperity.

Footnotes

1. This body of literature is extensive. For a concise summary, see Alan S. Blinder and Robert Solow, "Analytical Foundations of Fiscal Policy" in Blinder, Solow, et al. The Economics of Public Finance. Washington, D.C., Brookings Institution, 1974.

2. The Major work making this allegation is James Buchanan and Richard Wagner, Democracy in Deficit: The Political Legacy of Lord Keynes. New York, Academic Press, 1977. For a critique of Buchanan and Wagner, see Brian Barry, "Does Democracy Cause Inflation? Political Ideas of Some Economists" in Leon Lindberg, and Charles S. Maier, The Politics of Inflation and Economic Stagnation. Washington, D.C., Brookings Institution, 1985.

3. The Reagan administration program was notably based on the ideas of the "supply side" school, a variant of neo-classical economics focusing on the impact of tax rates as independent determinants of economic activity. These ideas remain controversial. For a critical examination of some of the tenets central to the Reagan program, see Otto Eckstein, "Tax Policy and Core Inflation". Study prepared for the Joint Economic Committee, 1980.

4. Note in particular the comments made by James Tobin and Franco Modigliani after the acceptance of their Nobel prizes.

5. See on this point Thomas Sargent and Neil Wallace, "Some Unpleasant Monetarist Arithmetic" in Federal Reserve Bank Minnesota Quarterly Review. Vol. 5, #3, 1981, pp. 1-17.

6. See Leonall C. Andersen, and Jerry L. Jordan, "Monetary and Fiscal Actions: A Test of Their Relative Importance in Economic Stabilization," Federal Reserve Bank of St. Louis Review Vol. 50, November 1968, pp. 11-24, Leonall C. Andersen, and Keith M. Carlson, "A Monetarist Model for Economic Stabilization," Federal Reserve Bank of St. Louis Review Vol. 52, April 1970, pp. 7-25, Dallas S. Batten, and Daniel L. Thornton, "Polynomial Distributed Lags and the St. Louis Equation," Federal Reserve Bank of St. Louis Review Vol. 65, April 1983, pp. 13-25.

7. For a review of this debate, see Bennett T. McCallum, "Monetary Versus Fiscal Policy Effects: A Review of the Debate". National Bureau of Economic Research working paper #1556, 1985.

8. See in this respect Martin Feldstein, "Government Deficits and Aggregate Demand". National Bureau of Economic Research working paper #435, 1980, and "Can An Increased Budget Deficit Be Contractionary". National Bureau of Economic Research working paper #1434, 1984.

9. See on this point Ray C. Fair, "Effects of Expected Future Government Deficits on Current Economic Activity". National Bureau of Economic Research working paper #1293, 1984.

10. G.R. Richards, "The International Business Cycle and the Monetary Reaction Function". Paper presented at the Midwest Political Science Convention, April 1985.

11. Organization for Economic Cooperation and Development, Budget Financing and Monetary Control. Paris, OECD, 1982.

12. Office of Management and Budget, Budget of the United States Government, Special Analyses. Washington, D.C., U.S. Government Printing Office, various years.

13. See on this issue Zvi Bodie, Alex Kane and Robert McDonald, "Why Are Real Interest Rates So High?" National Bureau of Economic Research working paper #1141, 1983, and Richard Clarida and Benjamin Friedman, "The Behavior of U.S. Short Term Interest Rates Since October 1979". National Bureau of Economic Research working paper #1273, 1984, and Robert Shiller, "Conditional Valuation and the Term Structure of Interest Rates". National Bureau of Economic Research working paper #1610.

14. See Organization for Economic Cooperation and Development, OECD Economic Outlook. Paris, OECD, various years.

U.S. MANUFACTURES TRADE - MAJOR PRODUCT CATEGORIES, 1980-1984

	U.S. EXPORTS			U.S. IMPORTS			BALANCE		
	1984 (\$b11)	CHANGE Fr '83 (%)	CHANGE Fr '80 (%)	1984 (\$b11)	CHANGE Fr '83 (%)	CHANGE Fr '80 (%)	1984 (\$b11)	CHANGE Fr '83 (%)	CHANGE Fr '80 (%)
TOTAL TRADE - Imports c.i.f.	217.9	9	-1	341.2	27	33	-123.3	-83.9	-66.9
Agricultural Products	37.6	4	-10	21.6	18	16	16.2	-1.6	-6.8
Manufactured Goods	143.1	-2	81	231.9	36	76	-88.8	-101.3	-101.3
Petroleum Products	4.6	-2	81	86.2	7	-24	-83.7	-3.9	-20.4
TOTAL TRADE - Imports Customs Value	217.9	9	-1	325.9	26	23	-107.9	-80.4	-62.2
Agricultural Products	37.6	4	-10	19.8	20	14	17.6	-1.6	-6.8
Manufactured Goods	143.1	8	-1	221.5	36	77	-78.4	-97.2	-97.2
Petroleum Products	4.6	-2	81	85.9	7	-24	-81.4	-3.7	-20.6
BY "END-USE" DEFINITION - Imports Customs Value									
Capital Goods	72.0	7	-1	89.8	46	102	17.2	-14.1	-30.8
Automotive Products	20.6	23	30	53.5	31	97	-32.9	-8.0	-21.7
Consumer Goods	13.3	-1	-18	60.0	34	74	-46.7	-16.2	-26.5
Industrial Supplies & Materials (Excluding Petroleum)	87.0	10	-16	66.4	24	27	-20.4	-7.7	-24.9
MANUFACTURED GOODS BY MAJOR SITC CATEGORIES - Imports Customs Value									
Chemicals (SITC 5)	22.4	13	8	13.7	27	69	8.7	-0.3	-3.4
Basic Manufactures (8)	19.1	1	-22	46.1	32	43	-27.0	-11.1	-21.1
--Paper	2.6	0	-3	2.6	43	46	-2.0	-1.4	-2.2
--Textiles	2.4	0	-3	4.6	41	35	-2.2	-1.4	-2.2
--Iron & Steel	1.2	-13	-58	10.9	60	46	-9.7	-3.2	-5.3
--Non-ferrous Metals	1.6	0	-47	8.2	11	8	-6.6	-0.8	-2.0
Machinery & Transport Equipment (7)	90.0	9	6	119.2	38	97	-29.2	-28.2	-52.8
--Office Machines & Computers	14.6	25	68	10.8	59	272	3.8	-1.1	-2.0
--Electrical Machinery & Parts	13.8	18	31	18.3	48	126	-4.5	-3.9	-6.9
--Power Generating Machinery (Including Engines)	9.1	5	7	7.3	38	92	1.8	-1.6	-6.4
--Non-Consumer Telecommunications Equip.	3.0	0	11	8.6	42	136	-4.6	-2.5	-4.5
--Construction & Special Purpose Machinery	8.0	7	-16	5.6	51	73	2.4	-1.4	-3.8
--General Industrial Machinery & Parts	7.9	-1	-24	6.9	44	77	1.0	-2.2	-5.5
--Machine Tools	1.2	9	-33	2.0	33	11	-0.8	-0.4	-0.8
--Agricultural Machinery & Tractors	1.7	6	-45	1.6	25	7	0.2	-0.2	-1.5
Automotive & Transport Equipment									
--Cars	4.9	17	26	29.7	28	74	-24.3	-8.8	-11.4
--Automotive Parts	4.0	21	-24	8.6	40	76	-4.6	-4.8	-5.9
--Aircraft & Parts	10.9	-11	-15	3.0	80	68	7.9	-2.3	-3.0
Miscellaneous Manufactures (9)	16.7	3	-4	42.6	34	79	-26.0	-10.3	-18.4
--Professional, Scientific, & Controlling Instruments	6.2	8	17	2.7	63	83	3.5	-8.5	-6.4
--Clothing	0.8	0	-33	13.6	41	111	-12.7	-3.9	-7.5
--Toys, Games & Sporting Goods	0.7	-22	-30	3.3	32	74	-2.6	-1.0	-1.7

SOURCE: NAM, from Statistics in Commerce Department, NEGOTIANTS OF U.S. EXPORT AND IMPORT TRADE

RATIO OF U.S. TRADE TO PRODUCTION & CONSUMPTION:
SELECTED MANUFACTURED GOODS CATEGORIES, 1972-1984

PRODUCT GROUP	EST. TOTAL 1984 U.S. SHIPMENTS	REAL AVG. ANNUAL GROWTH 1972-84	IMPORTS AS SHARE OF DOMESTIC CONSUMPTION			EXPORTS AS SHARE OF DOMESTIC PRODUCTION		
			1972	1981	1984	1972	1981	1984
A. HIGH TECHNOLOGY & ELECTRONIC PRODUCTS								
COMPUTERS	\$50.0 BIL.	19.1%	4%	7%	18%	22%	28%	27%
SEMICONDUCTORS	17.7	34.7	15	34	39	20	35	32
INSTRUMENTS -								
- Eng. & Optical Instr.	7.9	9.0	10	19	16	12	36	26
- Measuring & Control Instr.	9.5	6.1	4	5	5	19	21	16
- Electricity Meas. Instr.	7.5	9.3	8	12	11	20	31	22
TELEPHONE EQUIPMENT	12.6	4.2	2	4	13	7	7	6
AEROSPACE -								
- Civilian Aircraft	8.0	-0.5	2	22	29	28	65	58
- Engines	10.2	0.3	6	14	17	19	20	30
- Other Aircraft Equip.	12.4	2.3	11	18	20	26	41	40
PHOTOGRAPHIC EQUIPMENTS	16.2	4.5	7	15	16	12	16	15
IND. INORGANIC CHEMICALS	12.2	2.1	10	21	21	18	25	21

PRODUCT GROUP	EST. TOTAL 1984 U.S. SHIPMENTS	REAL AVG. ANNUAL GROWTH 1972-84	IMPORTS AS SHARE OF DOMESTIC CONSUMPTION		EXPORTS AS SHARE OF DOMESTIC PRODUCTION				
			1972	1981	1984	1972	1981	1984	
B. SELECTED OTHER INDUSTRIES									
ELECTRICAL EQUIPMENT -									
- Transformers	\$ 3.0 BIL.	-0.9%	3%	6%	10%	3%	8%	7%	
- Motors & Generators	7.7	0.6	5	10	13	9	12	10	
MACHINE TOOLS	3.9	-3.2	10	27	31	9	12	10	
CONSTRUCTION MACHINERY	10.7	-3.4	2	0	12	28	41	20	
FARM MACHINERY	10.5	0.1	10	13	17	11	23	22	
OIL FIELD MACHINERY	7.1	6.2	1	4	1	45	42	40	
GENERAL INDUSTRIAL MACHINERY -									
- Internal Combustion Eng.	9.2	0.1	6	6	5	15	24	21	
- Compressors	2.8	4.4	8	9	12	28	32	25	
- Pumps	5.8	2.1	4	9	7	16	18	16	
MOTOR VEHICLES (Passenger Cars Units)	114.0	2.6	8	19	16	2	5	2	
	-	-	15	27	25	-	-	-	
STEEL MILL PRODUCTS*	43.0	-4.1	17	19	22	3	3	1	
HOUSEHOLD APPLIANCES	15.6	1.6	7	9	13	4	10	7	
RADIO & TV SETS	6.7	7.6	37	59	59	4	10	10	
FOOTWEAR -									
- Leather Shoes	4.3	-3.6	17	33	51	0	2	2	
- Rubber & Plastic Shoes	0.7	-2.1	34	48	37	0	4	3	
TEXTILES & APPAREL -									
- Textile Mill Products	54.0	1.0	5	6	7	3	7	3	
- Man-Made Fibers	9.6	3.9	5	6	7	4	6	3	
- Apparel	57.3	1.2	7	12	20	1	2	2	

* - Steel trade on tonnage basis
(Note 1984 numbers based on Commerce Department estimates of total shipments.)

SOURCE: NAM from data in Commerce Department U.S. Industrial Outlook, 1985 and unpublished data.

JOSEPH B. FLAVIN
Chairman and Chief Executive Officer
The Singer Company

January 10, 1986

There is united agreement among the business community over the seriousness of the federal budget deficit. The Business Roundtable, other business organizations, and the senior managers of virtually all major corporations have identified deficit reduction as an economic imperative of our time.

Despite this consensus, we have experienced frustration over the inability of the Congress to deal with the deficit in an effective manner. The balanced budget amendment is a weak response and an exceptionally bad piece of legislation. It has little chance of working and, moreover, shows that the Congress refuses to establish our national priorities, then make the hard choices based on such an assessment.

Perhaps the basic factor that makes the deficit such a problem is that its danger to our national economic health is subtle and long term in nature. At this point, it is a cancer in the early stages, not a heart attack. Even so, there are early warning signs that we cannot ignore:

We know intuitively, and from experience and common sense, that living beyond our means is a route to disaster. We may be prospering today, but future generations will pick up the check at the expense of lower living standards.

When government claims an increasing share of the national wealth, it diverts resources from private control and thereby saps the lifeblood of a market-oriented economy. This is true in terms of the financing necessary for both technological innovation and improvements in our productive capacity.

Swollen deficits will ultimately reignite inflation. Should the gap between income and spending continue to widen, we will be forced to monetize the debt. That, in turn, could launch a new round of inflation that would far exceed even the lofty levels experienced in the 1970's and early 1980's.

This specter of renewed inflation is a major factor that is keeping long-term real interest rates high. In addition, the growing financing demand of the government is contributing to high interest rates. This would be even more evident if the borrowing requirements of business were not as low as they now are.

Deficits are creating a permanent debt load and an associated level of interest expense that will not go away even if we balance the budget immediately. To reduce debt would require a surplus in the budget, which is not in the cards. This underscores the necessity

to bring down and eliminate the deficit as quickly as possible.

This suggests we are backing ourselves into a corner. As government becomes more financially strapped because of the growing debt and interest expense, it loses the flexibility to alter tax and fiscal policy in response to changing economic circumstances, such as a recession or even a depression.

Finally, failure to deal with the deficit brings into question our ability to exercise national fiscal discipline. If we agree that deficits are bad, why can't we do something about it? This is perhaps the fundamental question we ought to be asking ourselves.

Combine all this, and it coalesces into the one factor that business management hates more than anything else: Uncertainty. How can we plan for the research that underpins innovation, or how can we commit to investments in productivity, if we are constantly shadowed by the overhang of outsized deficits?

In particular, the deficit and the debate it has generated put into jeopardy the defense industrial base and research and development programs that have long been recognized as essential to our national security. Private enterprise cannot maintain those resources in the absence of an assurance of consistent financial support. We observed how this kind of uncertainty resulted in the deterioration of our military position in the 1970's. Unfortunately, the current deficit situation, and especially the balanced budget amendment, raise that prospect once again.

The point is this: In dealing with the deficit, we must look beyond the prosperity of the contemporary economy and recognize the price that we and our children eventually will pay if we continue on our current course.

This is not to say that the deficit has no negative influence on our economic life now. Its primary impact currently is as a contributor to high real interest rates which, in turn, launch a succession of adverse forces. The most visible has been the role of these high rates in supporting an overvalued dollar, which has reduced the competitiveness of U.S. products at home and abroad. This has been a principal factor in the U.S. trade deficit that this year will reach the area of \$150 billion -- and which has seen an exodus of jobs and productive capacity to overseas locations.

We must, however, balance this bad news with some honesty. Like sin, deficits yield some pleasure -- even if it is transitory. In fact, another reason that it is so hard to cut the budget is that the money does not disappear into a chasm in Washington, but makes its way into the hands of the electorate.

We thus must examine the trends that led to the current situation and summon the national courage to attack the underlying causes of the deficit, even if that is politically difficult.

By now, there is little argument that the problem is excessive spending, not lack of income. In 1980, government took in \$517 billion in taxes; in 1985, that has grown to an estimated \$735 billion -- a 42 percent increase. Yet, we have seen the deficit soar to the \$200 billion plus level over this period.

Significant attention has been devoted to the military budget in this regard because of the President's commitment to a strong defense. However, a historical perspective reveals that the fuel powering the deficit engine has been increases in social insurance and pension programs -- that is, social security, medicare, Federal retirement, unemployment insurance, and similar programs.

For example, defense spending has declined from 8.4 percent of GNP in 1970 to an estimated 6.5 percent in 1985.

However, in 1970 spending on social security was equivalent to just over 3 percent of the GNP and medicare was .7 percent. In 1985, those two categories will represent an estimated 6.6 percent of GNP -- social security 4.8 percent and medicare 1.8 percent. Outlays for total entitlements and other mandatory expenses over this period rose from 7 percent of GNP to 11.3 percent.

The trend reflected in the above figures has caused the Business Roundtable and other organizations to insist that the effort to lower the deficit and ultimately bring the budget into balance focus on reduced spending. This, of course, has been the President's consistent position and I believe it is correct.

Tax reform should absolutely not be viewed in the context of raising revenue to assist in reducing the deficit. Rather, any new tax policy must serve as a vehicle to foster economic growth, while increasing the simplicity and fairness of the process. In fact, I have proposed that we shift to a modified flat tax coupled to a consumption-based tax to achieve these objectives, while maintaining revenue neutrality.

Therefore, our energies in deficit reduction must concentrate on lower spending. What we must do is return to the fundamentals and reaffirm that the role of government should be limited to national security; activities that benefit society but cannot be done privately, such as environmental regulation; and protecting those individuals who genuinely require assistance. Government now goes far beyond these functions and that is precisely the problem.

This is the issue we must face -- and solve -- if we are to cure the cancer of excessive budget deficits and secure the future for ourselves and future generations.

THE EFFECT OF DEFICITS ON SELECTED SECTORS OF THE ECONOMY

Discussion

Panelists

Peter Prichard, Associate Editorial Director, USA Today

Steve Wildstrom, Correspondent, BusinessWeek

Robert Krulwich, CBS Morning News

PETER PRICHARD: I come to this debate not as an economist, but as a citizen and as a journalist who looks at it as a layman and asks, what are we going to do about it?

I spend most of my time at the USA Today editorial board, which is composed of ten people chosen to reflect the nation in miniature. We have young people and old people, men and women, whites and blacks. We try everyday to figure out what we think about the problems in the nation. Our solutions, like all editorial pages, are sometimes good and sometimes sophomoric.

From time to time we bring politicians over to our building in Arlington, Virginia and ask them about these problems. Once this fall, we had [Senator] Bill Bradley and [Representative] Dick Gephardt over to talk about tax reform. They talked two hours about tax reform. We said, "That is very interesting, but what about the deficit, Senator? Can't we do anything about that?" He said, "Well, you can't do anything about the deficit without Presidential leadership." Our reaction was, "That may be true, but it is very depressing."

Not long after that George Bush came, so we asked the Vice President if he was worried about the deficit. Journalists always ask these leading questions because we hope the subject will make news by saying that he really is not worried about the deficit. Then we can write a headline that says, "Bush Not Worried About the Deficit." He was too smart for us. He said he certainly was worried about it. That was about the time Gramm-Rudman-Hollings was just emerging in the Congress, and we asked if it would mean raising taxes. He replied that he was afraid that if we were to raise taxes, Congress would just spend the money.

We did ask Senator Bradley and Representative Gephardt why Congress could not show some leadership. Their answer said more or less that Congress was not capable of showing that kind of leadership. I guess a disinterested observer could infer that from some of the comments made here today.

I think Gramm-Rudman-Hollings is an attempt to show some leadership; it is an attempt at an answer. We can ask whether having a cannon pointed at the head of the Congress that cuts every program to shreds on schedule is leadership. The people will decide that. Still, Gramm-Rudman-Hollings certainly is going to make us face the problem in the coming year. A participant in this meeting recently described Gramm-Rudman-Hollings as a mutual assured destruction policy for our fiscal policy, and I think there is probably some accuracy to that. It

may not be a great idea, but it may lead to the Grand Compromise that many see as necessary.

As an editorial board, we have struggled with this problem for three years now. Each year at January 1, we sit down to try to figure out what the ten most important priorities for the United States are. Each year we have said that the first priority is to protect the peace, thinking that if you are at war, the economy is not going to matter as much. The second priority in each of those years has been to reduce the deficit. Each of those years, Congress has not done anything. In our last editorial, we described the scene as: They get in the ring, stamp their tiny feet and shake their tiny fists, and then retire for another year. I hope that that does not happen this year.

In thinking about today's proceedings, I think perhaps the best thing the Committee For A Responsible Federal Budget could do to forge a new consensus on budget policy is to take the 24-hour tape that C-Span has prepared of this meeting, do some great editing to get it down to about 15 minutes of highlights, and present it to the President and hope he watches it. Then perhaps we would get some action in the next year, because someone with his proven ability to communicate and to forge consensus could probably help solve this problem. So far, unfortunately, I do not think he has been interested. And as far as I can tell, the Administration's representatives at this meeting do not seem very interested in solving the problem either. That is depressing to me as a citizen.

STEVE WILDSTROM: I've been a little distressed sitting here today listening to everyone talking about the virtues of cutting the budget deficit. Presumably we all believe that, or we would not have come here in the first place. Despite that agreement, there has been precious little said about how we want to do it. In this panel Governor Carlin came closer than most in offering a reasonably detailed scheme, but mostly what we have been hearing is oratory on the need to do it.

A feature of these gatherings in the past -- I guess it was left out this year because the format did not allow it -- has been the Exercise in Hard Choices. I have always found that the most interesting part of these Committee sessions. I'd like to try a little mini version by asking each of the presentors here: If we start with the assumption that some sort of revenue increase is needed, and everyone except Mr. Flavin seems to have incorporated that assumption into his presentation, what form ought it to take to produce the revenue we need to reduce the deficit while doing the least damage to the economy?

ROBERT KRULWICH: I did not know that C-Span was going to be here. Since I have just concluded a contract negotiation with CBS, which is an organization extremely jealous of its employees appearing on other networks, I would like to state that while I am thrilled to be on C-Span, in case anyone from my own network is watching, I did not know they were going to be here.

The impression I've formed listening to all these conversations is that the deficit, if it has done nothing else, has created a climate in

Washington where it is fair to ask perhaps of every citizen and of every Member of Congress about his or her constituents: Do your people, do you, deserve the benefits you are presently getting from the government? If not, you probably should be shorn of them. My impression, not only as a reporter, but also as a consumer of media -- I read a lot in order to keep up -- and based on today's presentations is that we can now pretty well identify the losers, at least in the short-term.

So the question is: Do you deserve the benefits that you are getting? In spite of Cy Brickfield's presentation on this panel, I think it is fair to say the impression is growing that old people -- generally defined as social security recipients, at least as described in the last year and a half on television, radio, and in print media -- are perhaps a little bit richer than they were. There is a growing sense that the benefits they are getting should be up for grabs. I say that mainly because the discretionary income they have is so large, or maybe because, as Cy Brickfield pointed out, while they are not that rich, their lot has improved more in the last 20 years than the middle-aged and the young. So in looking around for losers, I would put "old" on my list.

I would put "big business" on my list for much the same reason. Since 1981 the position of big business as a receiver of government benefits, and that would include tax expenditures, has improved relative to other taxpayers in the society. So now the perception is that they have had their turn. Now they are going to lose some. Generals and the Pentagon are also on the list. So that's my list: old, big business, and generals. As to farmers, I do not feel an image has gelled yet.

What about winners? Does anyone deserve more benefits? I think the answer, surprisingly, is yes. I predict that businesses and workers involved in trade will be seen by the Congress in the next year to deserve more benefits at least in the form of protection. How much will depend on events. And incredibly, though I do not know whether this is a question of deserving, I think the middle class may finish 1986 with more benefits. They have been promised lower tax rates sometime this year within the tax reform proposal. Whether or not most people in the middle class in America feel that they deserve lower rates, they have been offered them. And once you've been promised something, it's a little hard to get it out of your head.

So, for short-term solutions to the deficit problems, I think that we're going to be seeing the old people hurt a little bit; big business will be hurt a little bit; and the Pentagon will hurt a bit. If there is to be a winner, it might be the export oriented businesses. I would be interested in what Cy Brickfield thinks of that thought.

Now for some questions. There has been some discussion of "ouchless" solutions. I have not heard much about privatization; I'm interested in hearing what Sandy Trowbridge and Joseph Flavin think about some of the proposals we are likely to hear in the next six weeks. Will business welcome government obligations sold to the private sector? Could the postal system be privatized? Would anybody buy it or part of it; or prisons? Could air traffic controllers become employees of private business? In his paper Buddy MacKay mentions third-party

certification. I do not know what he feels about Federal inspectors being replaced by professionals on a contract basis, but I'd be interested to hear.

John Carlin referred to one other ouchless solution. If within tax reform we do get lower tax rates by the end of next year, would that free up the States to do more; that is, would it give them the opportunity to raise their taxes? Will we see more revenue sharing in the next year or two?

Finally, I am interested in the VAT. I know Joe Flavin is not, but I wonder does anyone on the panel think it has a chance in the next year or so, and particularly does anyone think it has a chance before the next recession? Only Mr. Flavin thinks we do not need more revenue, so I'll leave him out. Do those of you who think we do need to raise revenue think it can be done before the next recession, which seems to be predicted for late this year or early next? Those are my questions.

REP. DON BONKER: [In answer to Wildstrom's question] I will take a brief crack at a provocative question. Nobody reports the fact that while President Reagan has been very explicit that he will not support a tax increase, the tax reform bill which has just cleared the House at his insistence is a rather substantial tax increase on business, especially manufacturing. He lowers taxes for almost all the people, eliminating taxes for those at the poverty level, and then offsets those lower taxes with significant tax increases on business. In effect, he removes the tax incentives he put in place in 1981.

The tax bill, whether you call it the Reagan bill or the Rostenkowski bill, is a tax increase for some industries. If we enact that legislation, we will have preempted any effort to increase revenue in the future. We will have taken away many of the tax benefits we gave to the business community, and we cannot go back to individuals just six months after a tax cut and say we are going to raise their taxes. I think we ought to put aside tax reform and deal with the deficit. If we take back tax benefits, we should apply the revenue to deficit reduction. We should not make the bill revenue neutral.

ALEXANDER TROWBRIDGE: We've been asked to comment on a full agenda. I would like to comment on your advocacy of special help for businesses and labor involved in trade. We would be going down the wrong path if we provide help through protectionist legislation. A much better way is the one I hope is now under way, getting at the overvalued dollar. I think, as Don Bonker has said, that one way to hurt our ability to compete is to raise the cost of capital and add \$140 billion in taxes over five years, as does the Ways and Means Committee tax reform bill. The very sectors that have been in the toughest international competitive battles are the ones that bear the greatest burden in that bill.

About privatization, we have not heard that word before in these discussions, but we are going to hear it a lot more. The Administration's 1987 budget now in preparation relies heavily on the sale of government assets and privatization of what are now governmental activities. We do not know the details of these proposals. There are

some examples now at the State and local levels: in some areas waste collection and disposal is now a private activity; and some prisons are run on a contractual basis by private enterprise. Imposition of user fees clearly could be helpful where government is paying the full freight for private benefits.

I doubt very much that the post office is going to be sold. It is a \$26 billion operation. On the other hand it does not surprise me that you find Al Casey being brought in to run it; there is a real need for improvement in its ability to compete with private companies.

You mentioned the value-added tax. My guess is that it would be much too complicated and represent much too great a change in our basic tax system to expect it to happen this year. Nevertheless, there is a growing sense in the Congress and in the business community that for a long time we have tilted our tax policy in favor of consumption and against investment and savings. There is some interest in beginning to shift to a consumption-based tax. A value-added tax, if it were rebatable at the border, could offer some trade benefits. I think there will be a great deal of interest and debate. My guess, though, is that it is not a 1986 item.

JOSEPH FLAVIN: About the tax structure, we forget when we talk about "tax fairness" or say business got a break in 1981, that business tax breaks create jobs. I worry, as I know Sandy [Trowbridge] does, about the effect on jobs as the pendulum swings. One of the reasons I am against a tax increase of any substance right now is that we are very far into our recovery and in a very fragile position. If we have substantial tax increases, either individual or business, I fear for the job losses that would occur.

I am in favor of a consumption tax, but as a way to reduce marginal income tax rates. I would not go to a retail sales tax, Governor. I would like to see a wholesale tax; the States could then still tax above that wholesale tax. I would like to see us move very aggressively in this area and continue to reduce marginal tax rates. Although not all people agree that this creates more interest in business and work, I believe it does.

Finally, as to privatization, I would very much support it. Sandy, you said nobody would buy the post office; but you recall, those of us in business do not always sell at a profit.

CYRIL BRICKFIELD: The gentleman from CBS gave me the impression that he thinks the elderly are better off and more affluent. It is true, the elderly are better off, but they are not rich. In 1969, 20 percent of the elderly lived in poverty. Today it is 12 percent. That does not make them millionaires. Some 73 percent of social security recipients have annual incomes of less than \$14,000, and a big part of that is social security. How rich are you on \$14,000 a year? So we have to keep these things in perspective.

The older, single woman is the most economically disadvantaged person of all. Look at medicaid. Seventy-five percent of all of those

welfare beds are occupied by elderly, single women. Some talk as if there is a conflict between the young and the old because many young children are in poverty. You must remember that about 18-20 percent of these children who live in poverty are living in homes headed by a single mother. Perhaps the problem is more a social welfare problem than a social security problem.

I also say that Mr. Krulwich's belief that there is a resentment about the elderly is incorrect. Eighty-eight percent of those between 25 and 35 years of age look upon social security as a very good system. They do not want it touched. They do not want it frozen. They do not want benefits reduced. They want to leave it alone.

ROBERT KRULWICH: I feel I ought to just say something on my own behalf, being both a son and a grandson. My grandparents may be watching. My point is not that the elderly in America are too rich or not deserving. If, however, we are talking of zero-sum game here, or a negative-sum game, we are going to have to reduce government expenditures.

All I am saying is, take a look at the various constituencies: farmers, generals, big businessmen, old people, exporters, etc., and put your ear to the ground. Then ask yourself what impression is being formed by all the writing and reporting about these various constituent groups? I use the term loser in the image sense. It strikes me that in the last 15 months or so, the older Americans, big business people, and the Pentagon, for reasons that I think are apparent, have suffered on that image level. That translates directly into the political arena. Farmers and exporters have done relatively well compared to the first group. That is all I am saying. I am not advocating anything.

GOV. JOHN CARLIN: Someone commented that we are in the fourth year of recovery. As governor of a State where 13 banks closed last year, I have a hard time feeling a part of a great recovery that we want to hold on to. We would like to get out of the mess we are in and on to a recovery. Therefore, I am willing to be supportive of some things that others are a little more nervous about.

As to taxes, I would raise the oil import fee as a possible response to some of the questions here about specifics. It is a tax that might, in terms of timing, fit what is taking place today in that arena.

Regarding States' ability to accept additional responsibility with the passage of tax reform. Two things will determine the real answer to that question. First, the deductibility issue is a real one for State and local government. If there is tax reform and deductibility is retained, States would certainly be in a stronger position. Second, how the sorting is done is important. For example, of the programs you talk about eliminating, those that deal with economic development probably can be eliminated faster because the States would be able to sell tax increases to fund them. You can more easily sell a tax increase for economic development, for education, or for transportation, than you can for income maintenance programs.

So my response is two-pronged: If we can maintain the deductibility

of our taxes and if the sorting out can be sensible so that the additional responsibilities given to us are the ones that can be left logically to local and State government, then States and local governments can raise more taxes to complement the overall program that we are trying to develop to solve the deficit.

UNKNOWN: I would like to take exception to the statement that Brickfield made earlier in his testimony, namely that young people support social security. I suspect young people would rather invest the money on their own.

CYRIL BRICKFIELD: I gave you survey results. Members of Congress know this. Last July Members asked people of all ages about cutting social security, and they came back saying there was no real support to touch social security. That is why I believe that it was exempted from Gramm-Rudman-Hollings.

One other thing which I think is very important. Who are the young? The 30-year-olds, the 40-year-olds, and the 50-year-olds are the younger generations because they are still in the work force. They are still paying social security taxes and they still have elderly parents. They want to keep social security because, without it, they would be contributing \$1,000 a month or more to support their parents. At the same time, this middle generation is reaching down and helping the young.

STEVE WILDSTROM: I would like to ask a question of the panel. It is obvious from what we have heard here that everyone is trying to protect his interests as vigorously as he can, and certainly many of these interests have value and ought to be protected. But can anybody see a way out of this morass? If you agree that the deficit is a problem and if nobody wants to give anything up, what are we going to do about it?

REP. BUDDY MACKAY: Several of us here had the experience of trying to answer that question during the last session. For those of you who are either not required by your profession or else are too mentally balanced to follow the budget debate day by day, let me just tell you what happened during this last session. There is an emerging consensus, bipartisan and bicameral. The Leath proposal, which came out of the House without many votes, basically said we are going to freeze spending across the board, we are going to add selective cuts, and we are going to get a total of \$60 billion in spending cuts including a one-year freeze on social security; that will be coupled with \$15 billion in taxes. If we'd had any support from the President or the Speaker of the House, that would have passed.

In the Gorton/Chiles proposal, which was a bipartisan proposal, that same issue got to conference, and if there had not been an affirmative rejection by both the White House and the Speaker of the House, that would have passed. The consensus is here, and I believe it could happen.

Now what I would like to see the business community do is get together and say, "Look, there is a rational way to do this. Let's go to

work and try to do something constructive." And P.S., that would balance the budget in 3-1/2 years.

SEN. HENRY BELLMON: That is the most hopeful comment we have heard all day. Maybe we should quit right now.

BROWSER'S GUIDE

Session V

Budget Process and Budget Balance

No one is happy with the budget process. Alice Rivlin summarized the problems well: the process is complex, lengthy, time-consuming, and hard to understand; decisions are not made on time, and the results in recent years have been unsatisfactory to almost everyone.

Frustration with the budget process and its results was a driving force behind enactment of Gramm-Rudman-Hollings. Members of Congress were frustrated at the amount of time they spent to produce such unappealing results -- and what they saw as the failure of the press to cover the process well. Members of the press were frustrated by the nature of the story (how do you cover changing baselines?) and the tension between careful coverage and interesting coverage.

There was an amazing amount of discussion about the importance of economic assumptions in the budget and whether Congress actually should vote on GNP growth, the unemployment rate, and inflation!

It fell largely to Alice Rivlin and Rudy Penner to point out the positive aspects of the budget process. Rudy described the process as a "generator of information." In addition, as the media cover debates and votes, the process educates voters on budget issues. The fact that it is slow going should not lead to abandonment of the effort. Alice Rivlin tried to separate problems with the process from problems inherent in the nature of budgeting and faults of the process from failure of political will. There is, she reminded us, only so much one can ask of a process.

Near-universal agreement that the process could be improved did not equate to agreement on how it should be improved. Many maligned the sequester process in Gramm-Rudman-Hollings, but most agreed that bill made some salutary changes in the congressional budget process.

Representative Connie Mack would abolish the Budget Committees, and he favors a balanced budget constitutional amendment. Alice Rivlin and Dick Mooney would strengthen the Budget Committees. Alice would go further and combine authorization and appropriations committees. Alice Rivlin and Rudy Penner oppose a constitutional amendment to require a balanced budget. Several participants support a two-year budget cycle.

This session was illuminating as it illustrated the close link between participants' perceptions of appropriate budget policy and the kind of budget process each would favor. Each participant wanted to build into the process biases toward what they believe to be proper budget policy.

FEDERAL DEFICITS: SOURCE AND SOLUTION

by

Representative Connie Mack III

January 10, 1986

Introduction

Christmas Day, 1985, the front page in The Washington Post leads with a story boldly crying out, "OMB ASKS DEEP CUTS IN NIH." While the newspapers already had been picking apart the OMB "passback" to the agencies for days, the annual ritual of budget dissection for the FY 1987 season was now fully in swing.

The fundamental challenge in a cutback environment is translating the general agreement that deficits should be reduced into a specific blueprint for savings. The "we need cuts, but not in my program" mentality is legendary. While politicians always have been effective coalition builders in periods of budget growth, forging a consensus around a package of spending reductions is excruciatingly difficult.

The fact that Gramm-Rudman is now law not only is testimony to its political attractiveness, but also an explicit recognition that the politics of budgeting may well be entirely inconsistent with sound financial management of public resources. We have reached a stage where the end justifies the means. That is, Gramm-Rudman may not be ideal, but in the final analysis, eliminating the deficit (the end) was considered well worth the anti-rational spectre of a sequester (the means).

Gramm-Rudman must be considered in the context of a decade old budget process which witnessed unparalleled debt explosion. The FY 86 cycle of deficit reduction impotency, the symbolism of raising the debt limit above the two trillion dollar mark, and the residual embarrassment and concern over persistent red-ink spending, combined to create a climate ripe for action. A year earlier, Gramm-Rudman never would have emerged from the starting blocks.

Budget observers are watching the FY 87 budget process with unusual interest. Will Gramm-Rudman pass constitutional muster? Will Congress actually let a sequester stand? Can an accelerated budgeting timetable work? How will power relationships between committees in Congress evolve? Will the President comply if large defense cuts are mandated? Is a tax increase inevitable? These are but a few of the questions that are being raised as we move forward with first the executive and then legislative formulation of the FY 1987 budget.

It is fair to say that only time will answer these questions. For now, it is quite enough to confine our discussion to the following: (1) The source of our current deficit/debt crisis; (2) The procedural failings of the 1974 Budget Control and Impoundment Act and how, if at all, they are addressed by Gramm-Rudman; and, (3) if Gramm-Rudman is THE

solution, part of the solution, or not a solution at all.

The Source of Our Deficit/Debt Crisis

Half of our total national debt is the product of deficits run during the past five years of the Reagan Administration. Critics of the Administration thus claim that President Reagan's tax and defense policies since 1981 are the guilty parties. They argue that without the Economic Recovery Tax Act of 1981 (ERTA), government receipts might have been higher and without the defense buildup, spending certainly would have been lower. It is improper, however, to leap from these premises to the conclusion that Reagan tax and defense policies are responsible for our exploding debt.

To illustrate why not, consider trends in the share of our Gross National Product (GNP) represented by total receipts and defense outlays. Admittedly, GNP percentage is an imperfect measure. Nevertheless, it is a useful heuristic worth examination.

The passage of ERTA provided substantial across-the-board rate reductions, indexation of the zero bracket amount, personal exemption and individual income tax brackets, and the accelerated cost recovery system (ACRS) for depreciation of capital expenditures. No one contests the claim that ERTA was in fact a substantial tax reduction. However, on the heels of ERTA came TEFRA (Tax Equity and Fiscal Responsibility Act of 1982), the Highway Revenue Act of 1982, the Social Security Amendments of 1983 and the Deficit Reduction Act of 1984. Over time, the combination of subsequent tax action and "bracket creep" virtually offset the reductions of ERTA (see Table V).

As a percentage of GNP, the government's receipts this past year were roughly equivalent to the level of receipts characterizing the second half of the 1970's. Table II illustrates that from 1975 through 1979, the level of government receipts averaged 19.0%. From 1980 through 1985, receipts rose to an average of 19.5%. Had the level of receipts held constant at 19.0%, *ceteris paribus*, the national debt over these past six years would have been \$100 billion larger!

With the benefit of hindsight, it therefore is fair to say that ERTA only had the effect of maintaining the previously existing aggregate burden on taxpayers and businesses, preventing what would have been a huge tax increase. The composition of the burden, however, certainly shifted. From 1980 to 1984, as a percentage of total receipts, individual income tax dropped from 47.2% to 44.4% while corporate income tax fell from 12.5% to 8.5%. These decreases were compensated for by sizeable increases in social insurance and excise taxes. Tax policy over the past five years thus has been meaningful in terms of how the blood is being drawn, but not in terms of how much blood actually was taken.

Analyzing defense spending trends as a percent of GNP is a bit more difficult. Our country has been involved in a variety of confrontations over the years that dictated spending increases.

Moreover, the nature of the threat we face continues to evolve. Defense strategy and attendant expenditures consequently should not necessarily follow the funding patterns of earlier years. That said, it remains valuable to examine how much of our nation's resources we have dedicated to the essential purpose of government, providing for our collective security.

Tables III and IV compare expenditures for national defense to those for human resources, physical resources and other elements of the budget. Table III provides share of GNP data, while Table IV indicates the share of the federal budget each of these categories constitutes.

In the post-Korea, pre-Vietnam, missile crisis and Great Society context of 1960, defense spending stood at 9.7% of GNP. A decade later, in the midst of Vietnam, the defense share had fallen to 8.4%. By 1979, following our exit from Vietnam and after SALT negotiations, defense spending declined even further to 4.9%.

This steady erosion of our nation's security posture would not have been so dangerous had the Soviet Union also curtailed its own defense effort. But rather than reallocating spending toward domestic programs as we did, the Soviet Union coupled an unprecedented increase in defense spending with brazen adventurism around the globe.

President Reagan's initiative to rebuild our defense capabilities reflected the broad consensus of the American public. Even more significantly, however, it is apparent that spending in the decade of the 1980's is not at all incongruous with our recent historical experience.

No matter how you view defense, by post-World War II standards, the 5.2% of total GNP allocated to defense spending between 1975 and 1979 is quite low. In 1985, defense spending represented 6.6% of GNP, and if one were to make the rather imaginative assumption that the President's defense request for FY 86 would be carried cut through 1990, the share of GNP rises only to 7.5%.

The facts simply do not support the argument that as a society, the U.S. has ignored its other priorities in favor of defense. In fact, spending on human resources is up very substantially from 1970 and spending on physical resources has remained fairly constant. But more relevant to this discussion, the data also fairly definitively suggests that deficits in the range of 4-5% of GNP are not the product of "excessive" defense spending.

So what is the source of our debt crisis? When you look at what has happened since 1970 to national interest costs, and note that roughly 70% of the FY 86 deficit will be attributable to debt payments, the answer seems clear. The historical burden of deficit spending, combined with the catalytic impact of the past recession, have created an automatic 15% drain on our budget for which we get no program investment.

The elimination of "bracket creep," an integral feature of responsible taxing policy, prevents Congress from automatically cheating the taxpayer to make up the difference. And politicians, to date, have

been unwilling to make the program reductions required to compensate for the growing share of debt costs. As a result, America's leaders have muddled through the past few years without breaking out of the fundamental mathematical impasse characterizing the federal budget process. Hence, Gramm-Rudman...

More than anything else, Gramm-Rudman asserts deficit primacy -- a belief that politically, if not economically as well, deficits represent the most important problem facing Congress. As a corollary, Gramm-Rudman biases solution to the problem on the spending side, with certain programmatic preferences reflecting an uneasy consensus on spending priorities (i.e., exempting Social Security, limiting vulnerability of health programs, and making a 50-50% burden split between defense and remaining domestic activities).

Budget Process Procedural Failings

Just over a decade ago, Congress passed the Congressional Budget Control and Impoundment Act of 1974. This landmark legislation, as its name implies, was designed to improve "control" over the federal budget. Before its enactment, Congress never really looked at the big picture. Rather, funding decisions were reached in piecemeal fashion, the dollars were added up, and at the end of the year, legislators discovered how large the deficit had grown. Red faces generally accompanied red budgets.

One of the primary purposes of the 1974 Act, therefore, was to force Congress to explicitly consider the deficit effect of its program decisions from the start, before tax dollars were actually authorized and appropriated for expenditure. It was thought that by creating an overall budget plan, legislators would become stingier with the public purse and downward pressure on spending finally would be established. Despite noble intent, however, perhaps the only real accomplishment of the 1974 Act was to keep the federal budget in the headlines, providing new opportunities for tough, but largely empty, rhetoric.

The key procedural failings of the budget process, some of which pre-date the 1974 Act, follow...

Failure to Follow Timetable

The Budget Committees in both the House and Senate routinely fail to report the first budget resolution on time. Consequently, the entire funding process is thrown off track. The implications are significant because other committees then operate without the constraining influence of fiscal limits. Moreover, the inevitable result of perpetual tardiness is excessive reliance on continuing resolutions to fund government.

No Effective Enforcement

The Committee structure virtually dooms the process and guarantees excessive spending. Since program funding decisions are routed through

the Budget Committee, authorizing committees and the appropriations subcommittees, there are at least three distinct competitors for policy control, each with its own agenda and unique set of priorities. Although the Budget Committee ostensibly sets binding totals, these totals are regularly evaded. In fact, over the last six fiscal years, actual deficits were nearly \$300 billion greater than those envisioned in the first budget resolutions.

Scoring Obfuscation

Because Congress budgets, authorizes and appropriates along vastly different groupings of programs, it is extremely difficult to "keep score" on whether the budget totals are being honored. Over the course of time, spenders also have become very creative with gimmicks designed to understate spending. Perhaps the best known of these gimmicks is deliberate underfunding of a program during its appropriation. The food stamp program is the classic example. Underfunding enables program advocates to claim that budget totals are not being breached. Of course, the funding is then restored in a supplemental, albeit rather quietly.

Excessive Reliance on Continuing Resolutions and Supplementals

Theoretically, Congress appropriates money for federal programs through thirteen different appropriation bills each year. In reality, however, each year Congress is forced to pass a Continuing Resolution to keep government functioning. More often than not, CRs turn into "Christmas Trees." That is, they are loaded up with extraneous funding items and bloated spending levels. The comprehensive nature of these bills and their late timing render them almost veto-proof.

The problem with supplementals is analogous. There are legitimate reasons for a supplemental appropriation -- a federal disaster for instance. However, these bills too tend to include spending for less than critical objectives. The FY 85 Supplemental funded a boll weevil eradication program, a study of "cigarettes with reduced propensity to ignite upholstered furniture," research on shrimp aquaculture, \$171 million to begin new water projects, and, of course, \$318 million for the food stamp program.

Baseline Confusion

The concept of a baseline for assessing budget decisions makes a great deal of intuitive sense. But current usage of the baseline creates at least five critical problems. First, Congress legitimizes and even encourages inflation by automatically factoring increased costs in its budgeting. Second, Congress overstates the savings achieved in its deficit reduction efforts. Third, increases in revenues due to economic growth are not dedicated to deficit reduction; instead these revenues are simply spent. Fourth, baseline budgeting biases spending decisions in favor of existing policy choices; the baseline presumes continuation of government programs without changes even though it may be possible to

achieve the same objectives in less costly fashion by developing new approaches. And, fifth, baselines are inherently fallible in that they embody imprecise economic and demographic projections.

Gramm-Rudman likely will enjoy mixed success in countering these failings. The importance of "scoring" will increase, but little, if anything, is done to clarify measurement techniques. The new process also will be even more reliant on baselines, but does nothing to correct the deficiencies of baseline dependency.

To its credit, Gramm-Rudman accelerates the budgeting timetable, thereby increasing the probability that Congress will complete action on budget resolutions earlier in the calendar year. Supplementals now must be zero-sum -- any increases will have to be accompanied by offsetting decreases. Undoubtedly the most critical improvement, however, is in enforcement. The threat of an automatic sequester will vastly improve incentives for Congress to budget in a more timely and honest fashion. The sequester also guarantees that the deficit objective will be met, either by congressional design or automatic reductions.

On balance, Gramm-Rudman represents a substantial improvement in procedures. It may make budgeting more cumbersome for Congress, but it is results-oriented. And although the programmatic implications of an actual sequester are not preferred, if in fact we agree with the principle of deficit primacy, the new congressional budget process will be far more effective than the process of the past decade.

The Solution, Part Solution, or Neither?

Just over a decade ago, deficit phobia and concern over presidential impoundment authority combined to produce a new and complex congressional budget process. Ten years of escalating deficits since then provide compelling evidence that deficit spending cannot be permanently constrained by procedures alone. The axiom that rules are meant to be broken seems to be literally interpreted when it comes to federal budgeting.

The nature of politics itself is responsible for fiscal irrationality. Members of Congress have more to gain by increasing spending for their constituents than by exercising a tight rein on the public purse. A water project, for example, may make considerable sense at the local level, particularly when its cost is spread among taxpayers in fifty states, although on a national scale, the local benefit cannot possibly justify the federal expenditure.

On December 11, 1985, after several months of intense and arduous negotiations, both chambers of Congress passed the "Balanced Budget and Emergency Deficit Control Act of 1985," better known as the Gramm-Rudman initiative. This proposal for systematic deficit reduction totally revamps the 1974 Budget Act. For the first time in history, Congress has placed financial limits on its spending plans. Gramm-Rudman is the roadmap to financial accountability.

Nevertheless, Gramm-Rudman does not in and of itself make the choices necessary to ultimately balance the budget. As Congress considers budgets in the coming years and struggles to live within the set deficit ceilings, there will be tremendous pressure to raise taxes. The deficit issue thus may well be reduced to a question of increased taxes versus lower spending.

Although Gramm-Rudman certainly strengthens the procedural incentives to cut spending, it must be fully recognized that it is nothing more than a new set of procedures. Procedures can be legislatively modified or repealed, judicially overturned, or as the history of the 1974 Budget Act suggests, violated in practice. Consequently, the inescapable bottom line is that if the objective is to achieve and maintain a balanced budget, there is no substitute for a constitutional amendment mandating that government outlays not exceed revenues.

Earlier, it was argued that at least by historical comparison, the federal deficit is due neither to inadequate taxation nor an excessive commitment to defense. The lion's share of our present deficit gap is due to the cost of servicing our national debt. The challenge Congress faces, made more acute in the Gramm-Rudman context, is how the gap should be eliminated. The conclusion of this analysis is that a policy choice to raise taxes in order to meet the deficit ceilings articulated by Gramm-Rudman would be a grave error.

So long as Congress has to cope with politically and economically distasteful deficits, there will be continued pressure to tax away the problem. It is essential that our country reach a consensus on the appropriate size of our federal public sector, at least under peacetime conditions. A cornerstone, therefore, of a balanced budget amendment must be a limitation on aggregate taxation at a level consistent with the consensus on the proper size of the federal government. Only by coupling such a tax limitation with the constitutional amendment can Congress truly and finally solve the deficit/debt crisis we face.

TABLE I

BUDGET TOTALS AS PERCENT OF GROSS NATIONAL PRODUCT (GNP)

	<u>Receipts</u>	<u>Outlays</u>	<u>Surplus/Deficit(-)</u>
1940	6.9	10.0	- 3.1
1945	20.8	42.7	-21.9
1950	14.9	16.1	- 1.2
1955	17.2	18.0	- 0.8
1960	18.6	18.5	- 0.1
1965	17.7	17.9	- 0.2
1970	19.9	20.2	- 0.3
1972	18.4	20.4	- 2.1
1974	19.1	19.5	- 0.4
1976	18.2	22.7	- 4.5
1978	19.1	21.9	- 2.8
1980	20.1	22.9	- 2.9
1982	20.3	24.5	- 4.2
1984	18.6	23.8	- 5.2
1986 OMB	18.9	23.2	- 4.3
CBO	19.1	23.3	- 4.2
1988 OMB	19.3	22.2	- 2.9
CBO	19.5	22.5	- 3.0
1990 OMB	19.5	20.9	- 1.4
CBO	19.5	21.7	- 2.1

 Historical data from OMB. OMB future projections based on FY 86 Budget Request. CBO future projections based on August 1985 estimates.

TABLE II

REVENUES: SHARE OF GROSS NATIONAL PRODUCT (GNP)

(Dollars in billions)

<u>FY</u>	<u>GNP</u>	<u>Revenue</u>	<u>% of GNP</u>
1975	1479.9	279.1	18.9
1976	1640.1	298.1	18.2
Transition Quarter	432.2	81.2	18.8
1977	1862.8	355.6	19.1
1978	2091.3	399.7	19.1
1979	<u>2357.7</u>	<u>463.2</u>	<u>19.7</u>
1975-79	9864.0	1876.9	19.0
1980	2575.8	517.1	20.1
1981	2885.9	599.3	20.8
1982	3046.0	617.8	20.3
1983	3221.4	600.6	18.6
1984	3581.1	666.5	18.6
1985	<u>3840.0</u>	<u>737.0</u>	<u>19.2</u>
1980-85	19150.2	3738.3	19.5

 1975-1984 data from OMB. 1985 estimate based on August 1985
 CBO report.

TABLE III

MAJOR BUDGET CATEGORIES: PERCENT OF GROSS NATIONAL PRODUCT (GNP)

	<u>National Defense</u>	<u>Human Resources</u>	<u>Physical Resources</u>	<u>National Interest</u>	<u>Other Functions</u>	<u>Undistributed Offsetting Receipts</u>	<u>Total</u>
40	1.7	4.4	2.4	0.9	0.8	- 0.3	10.0
45	38.2	0.9	0.8	1.4	2.0	- 0.6	42.7
50	5.2	5.4	1.4	1.8	3.0	- 0.7	16.1
55	11.2	3.9	0.7	1.3	1.8	- 0.9	18.0
60	9.7	5.3	1.6	1.4	1.6	- 1.0	18.5
65	7.7	5.5	1.7	1.3	2.6	- 0.9	17.9
70	8.4	7.8	1.6	1.5	1.8	- 0.9	20.2
72	7.0	9.5	1.7	1.4	1.7	- 0.8	20.4
74	5.8	9.8	1.8	1.6	1.8	- 1.2	19.5
76	5.5	12.4	2.4	1.6	1.6	- 0.9	22.7
78	5.0	11.6	2.5	1.7	1.9	- 0.8	21.9
80	5.2	12.2	2.6	2.0	1.7	- 0.8	22.9
82	6.1	12.8	2.0	2.8	1.7	- 0.9	24.5
84	6.4	12.1	1.6	3.1	1.5	- 0.9	23.8

OMB data.

TABLE IV

MAJOR BUDGET CATEGORIES: PERCENT OF TOTAL BUDGET

	<u>National Defense</u>	<u>Human Resources</u>	<u>Physical Resources</u>	<u>National Interest</u>	<u>Other Functions</u>	<u>Undistributed Offsetting Receipts</u>	<u>Total</u>
40	17.5	43.7	24.4	9.5	8.2	- 3.4	100
45	89.5	2.0	1.9	3.4	4.8	- 1.5	100
50	32.2	33.4	8.6	11.3	18.7	- 4.3	100
55	62.4	21.8	4.0	7.1	9.8	- 5.1	100
60	52.2	28.4	8.7	7.5	8.4	- 5.2	100
65	42.8	30.9	9.5	7.3	14.5	- 5.0	100
70	41.8	38.5	8.0	7.3	8.8	- 4.4	100
72	34.3	46.5	8.5	6.7	8.2	- 4.2	100
74	29.5	50.4	9.3	8.0	9.1	- 6.2	100
76	24.1	54.8	10.5	7.2	7.3	- 3.9	100
78	22.8	52.8	11.5	7.7	8.6	- 3.4	100
80	22.7	53.0	11.2	8.9	7.6	- 3.4	100
82	24.9	52.1	8.3	11.4	6.8	- 3.5	100
84	26.7	50.7	6.8	13.0	6.5	- 3.8	100

OMB data.

TABLE V

WHAT IS LEFT OF THE TAX CUT?

FY 1981 - FY 1989
(\$ billions)

		Fiscal Years 1981 through 1989
Tax cut:	Economic Recovery Tax Act of 1981 (ERTA)	- \$1,488 billion
Tax Increases:	Inflation-Induced Bracket Creep	+ 650
	1977 Social Security Tax Rate Increases	+ 287
	Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)	+ 311
	Gasoline Tax Increase	+ 28
	1983 Social Security Amendments	+ 90
	"Downpayment"	+ 101
	Other	+ <u>9</u>
Total Tax Increases.....		+ \$1,476 billion
Net Tax Cut.....		- \$ 12 billion
Nine Year Average Net Tax Cut.....		- \$ 1.4 billion

Department of the Treasury, August 1984.

BUDGET PROCESS AND BUDGET DEFICITS

by

Rudolph G. Penner
 Director
 Congressional Budget Office

January 10, 1986

It seems appropriate that one of the most important contributions to the theory of legislative processes was made by the mathematician Charles Dodgson a.k.a. Lewis Carroll, the author of Alice in Wonderland. Puzzled by the results when the Dons at Oxford voted on the wines to be served at high table each evening, Dodgson found that majority voting could lead to the result that wine A was preferred to wine B, wine B was preferred to wine C, but wine C was preferred to wine A. Consequently, the final choice of wine depended solely on the order in which the selections were presented. This illustrates that legislative processes are very important, and occasionally they can be very capricious, leading to results that are not preferred by any of the participants.

The budget process possesses some of these same characteristics, though for reasons that often differ from those observed by Lewis Carroll. Specifically, the budget process has recently been associated with the largest deficits experienced in our peacetime history -- a result deemed undesirable by almost all participants. But is the budget process really to blame?

The process was designed in 1974 to bring about a rational consideration of our budgetary choices as they are constrained by our economic resources. By setting targets for total outlays and receipts -- and therefore, for the deficit -- and by requiring votes on those targets, the process was supposed to prevent legislators from claiming that they were simultaneously in favor of more public programs, lower taxes, and a balanced budget. In other words, it was designed to deal a fatal blow to the notion that there was a free lunch out there -- a concept much beloved by legislators and voters alike.

To argue that the process worked perfectly would be highly naive, given the results. It would be equally naive, to believe that a mere process could, by itself, kill off a concept as popular as that of a free lunch. Probably the best we can do is to weaken the free lunch monster with a thousand pin pricks. It is in that context that the budget process must be analyzed.

Putting the matter another way, the process is bound to fail if it immediately attempts to discipline participants who face a bad set of political incentives -- that is to say, incentives that bring about outcomes that do not reflect the preferences of a majority of the voters. A good process must work directly on the incentives and attempt to improve them.

How does the budget process do that? My view is that the essence of the budget process is that it is a generator of information. By requiring votes on certain issues at certain times, it provides information to the voters on the tastes of their elected representatives, and it creates a strong incentive for legislators to become informed about important issues that might otherwise be ignored. As an important byproduct, it also educates voters on budget issues, as the media cover debates and votes that would not otherwise occur.

But educating voters is a slow process, and it is particularly difficult with regard to budget issues, because they cannot be said to be fun to read about. Indeed, most people find them downright boring.

Despite these difficulties, however, it is my strong view that the budget process has, in fact, made an important contribution to the public's being informed. It has kept budget issues on the front page, or at least on page three, of most newspapers for a large part of the year. And it is my experience when I give speeches around the country that I can now assume much more knowledge on the part of audiences than was possible five years ago. But progress is slow, and I do not mean to imply that the ordinary voter is now fascinated by discussions of budget baselines, rescissions, spendout rates, and the other paraphernalia that go into putting a budget together.

Progress on the budget deficit has paralleled the education of the voter. Its pace has been glacial. Disappointment that we have not been able to do more, however, is often translated into the statement that we have done nothing at all. That could not be further from the truth. Though progress has been slow, it has had a significant cumulative effect.

It is not my job to say whether we have done the right things in our recent attacks on the deficit, but I can say that the dollar effects have been impressive. Since the deficit problem emerged in the early 1980s, the restraint on nondefense spending has been nothing short of remarkable. In fiscal year 1985, this category's share of the gross national product (GNP) was not only much lower than that of 1975, but even lower than that of 1965, before Great Society spending got rolling. There has also been a major change in the path of defense spending. As recently as October 1984, the Congress voted for a 5 1/2 percent annual real increase in budget authority. In July 1985, it voted for a zero real increase in fiscal year 1986 and for 3 percent real growth in 1987 and 1988. This change alone saves about \$40 billion in outlays in 1988. Recent appropriation actions actually provide for less than zero growth in 1986.

Entitlement spending is still growing, but it has been slowed by a courageous Social Security reform in 1983, and significant cuts in medicare, civil service pensions, and other programs. And this anti-tax society has endured four significant tax increases in the last four years. We have had the Tax Equity and Fiscal Responsibility Act (TEFRA), a payroll tax increase, a gas tax increase, and the Deficit Reduction Act of 1984 (DEFRA).

The fact that we still have a huge deficit is more a testimony to

the extraordinary size of the earlier mismatch between revenues and outlays than it is to a lack of effort to do something about that mismatch. Even if we go back to February 1984, the Congressional Budget Office's (CBO) annual report portrayed an alarming situation. The laws in effect at that time implied future deficits so large that the amount added to the interest bill on the public debt each year was itself a major part of the budget problem. The situation threatened to explode, with the interest bill rising so fast that it could not possibly be countered with tax increases or spending cuts. In those circumstances, hyperinflation would have been an almost inevitable result. Since that time, we have at least stabilized the situation--albeit still at a very undesirable level.

Does this progress, though still insufficient, indicate that we are at least slowing down the free lunch monster that I discussed earlier? Unfortunately, the current budget process suffers an important weakness when battling this apparition. That is, it is highly dependent for its operation on the stipulation of a set of economic and technical assumptions that defines the amount of revenue available to finance spending programs. By basing budget decisions on an overoptimistic set of assumptions, the process can create the illusion of a free lunch where none exists.

The choice of extremely optimistic assumptions in 1981 certainly contributed to our current difficulties, and in the short run, there are always strong pressures to err on the side of optimism. Using bad assumptions obviously leads to bad decisions, but it is also important to note that, in the longer run, having made bad assumptions is also demoralizing. Difficult and painful policy decisions are made in the hope of reaching a specific deficit target; but when the economy fails to perform as was assumed and the deficit target is exceeded, everyone has a sense of failure. This holds even though the situation would have been still worse if the painful decisions had not been made in the first place.

Remedying this problem is not easy, because economic forecasting is in such a primitive state that it is impossible to say in advance with any confidence that the more optimistic scenario will fail to materialize. And sometimes, as in 1984, the assumptions used for budget deliberations turn out, in retrospect, to have been too pessimistic. Unfortunately, this is a rare event.

Yet, even on this difficult issue, there has been some progress. Early in the history of the budget process, it was the custom for both CBO and the Administration to base long-term economic assumptions on goals for economic growth, unemployment, and inflation. Obviously, ambitious goals are desirable, but since they are seldom fully achieved, budget figures based on them turn out to be misleading. More recently, CBO and the Administration have been much more influenced in formulating assumptions by how the economy actually has performed historically than by how we wished it had performed. While the Administration's long-term assumptions still tend to be more optimistic than CBO's -- and perhaps this is appropriate for various reasons -- both sets of assumptions are now well within the range of actual experience.

Another important reform has added to the realism of budget productions. In the days before the income tax was indexed, projections based on current law showed revenues rising far more rapidly than incomes because of "bracket creep." For that reason, it was hard not to project a balanced budget a few years out. Politically, the projection was totally unrealistic because the Congress never let bracket creep go on very long, and in the aggregate, it was offset by so-called tax cuts. With indexing, our projections now eliminate bracket creep caused by inflation, and so future revenues change very little relative to GNP.

Perhaps the most important reform of all has come with the enactment of Gramm-Rudman-Hollings. The Congress and the Administration have now deprived themselves of the right to choose their own economic and technical assumptions for important parts of the new budget process. Instead, they will be supplied by technicians operating out of OMB, CBO, and GAO.

More generally, Gramm-Rudman-Hollings provides a whole array of new weapons with which to escalate the war on the free lunch idea. Some observers have searched for an analogy in the Mutual Assured Destruction, or MAD, theory of nuclear deterrence. Let up hope instead, that, in this case, a surgical first strike will be successful.

ALICE RIVLIN

January 10, 1986

I would like to talk about a couple of very fundamental questions. Why are we having such enormous difficulty with the U.S. government budget? Why are we having such enormous difficulty with the U.S. government budget -- why all this agony? Are there process changes that would help? My answer, not to keep you in suspense, is that there may be a few that would help, but process isn't everything. We have to have will and leadership.

Budgeting is always difficult. This is true whether the budget is for a family, a business, or a government at any level. Budgeting is an inherently difficult thing to do. There are always limited resources and, as this organization has publicized, hard choices.

There are four conditions that make budgeting especially difficult. First budgeting is more difficult if there are many choices on the spending or the income side. That is true whether it is a family or a government. It is not true that it is better to be poor, but if you are poor it is easier to make a budget. You have to eat and you have to pay the rent, and there are not a lot of other decisions to be made. That is true of governments, too. A poor government has to defend the borders and deliver the mail, and there is not much else to decide. Difficulty is greatest in the situation of the United States which is a rich country with global responsibilities and lots of things the nation wants to do.

Second, budgeting is more difficult if you have access to credit. If you are a family or a government that cannot borrow, you are a lot worse off but your choices are not as hard. You have to make spending and the revenues match. Credit makes a lot of good things possible, but it has to be managed responsibly, and it certainly complicates budgeting.

Third, budgeting is much more difficult in a world of high uncertainty, either about income or about the cost of what one would like to do. Everybody lives in a world of uncertainty -- especially governments about the economy.

Finally, budgeting is much harder when there are multiple decision makers involved and these decision makers have different priorities. This is the big problem with any institution and the one for which you need a budget process. The process is designed to resolve those conflicts. This is where the U.S. government is in a particularly difficult position, left to us by our forefathers. They built into the Constitution an inherent difficulty: the President runs the government and articulates priorities, but the Congress has the ultimate authority over spending and taxing, subject to his veto. Unless we want to change that fundamental organization of our government, we're going to have agonizing difficulties over the choices involved in making a budget whenever the President and the Congress have fundamentally different ideas about what the government ought to be doing and how it ought to be paid for -- unless the President is very strong, articulate, flexible enough to work with the Congress and persuade them to take part of his position while taking some of theirs and so moving things ahead.

For the last four years, we have had the first condition -- different priorities in the Congress and the White House -- but not the second. We have had a President who has had a very different idea about what the government ought to do, but has until recently been reluctant to lead and compromise with the Congress, at least on deficit reduction. He has been more inclined to confront that to lead, although there are certainly signs in his second term that he will compromise on some things, at least on defense.

Now what can a budget process do for you? It can only do two things, if you are unwilling to limit the choices available or to restrict the use of credit. First, it can reduce uncertainty, but it cannot eliminate it, for the reasons Rudy has eloquently described. A good process can generate the best projections available as to costs and effects, and it can supply them to the decision makers at the proper time. Then, at least, everybody understands as well as possible what the choices are, and everyone has access to the same estimates -- even if they do not always agree on them.

Second, it can organize the decisions in a logical order so that the most important issues get attention. It can economize on decision makers' time and energy. It can focus their attention on the right things. It can help prevent exhaustion caused by too many stages and too many committees. Thus it can help prevent frustration caused by the inability to finish budgeting in a timely fashion.

What no process can do is force participants to make decisions they do not want to make, or that they do not believe are necessary. If power is inherently divided and different members of the power structure have different ideas about what they want to do, no mere process can resolve that conflict. Resolving it takes leadership skill and willingness to compromise. The process cannot supply that.

The pre-Gramm-Rudman-Hollings-and-all-those-other-people budget process is pretty good on supplying information and, as Rudy says, in that regard it is getting better. It is pretty good at focusing the decision makers on the right decisions. That was not true, pre-1974, but today's lawmakers are debating what they ought to be debating: the size of the government, the size of the deficit, priorities as between defense and domestic spending.

The current budget process, however, does little or nothing to economize on policymakers' time and energy. It needs a drastic overhaul to make it more manageable and less complicated. There should be fewer decisions. Congress should not be micromanaging at the level that it today. There should be fewer budget accounts, for instance. The process should have fewer stages, and here I would agree with Connie Mack that we could consolidate the committee structure. I would not exactly do it his way. I think what you need is one committee -- you can call it a budget committee or anything else -- whose job it is to trade off priorities as between the major areas of the budget and to look at the match between spending and revenues; the Committee would bring a proposal to the floor on those issues. That is what we now call a Budget Committee. You need a single committee for each major part of the budget: a defense committee or a health and education committee, and you need a tax committee, but you don't need the duality of appropriating and authorizing. If we ever needed that, we cannot afford it anymore; it's too complicated.

Finally, we need to budget less often. We could go through this agony every other year instead of every year. It would not make it easier, but at least it would not tie up so much time. I think if we simplified the budget process somewhat as I suggested, everybody would feel better, and the job would get done, not more easily, but at least with less feeling of failure.

None of those process changes would change the basic conflict or supply us with leadership or with the willingness to compromise. What do you do if leadership or the willingness to compromise is lacking? Whether you are a family or a government, you can choose a dictator. You can say, at least temporarily: Daddy makes the decisions. Or you can limit the choices artificially. You can say: No more borrowing, or let's make a rule to cut everything by ten percent. When a family acts this way, the costly nature of the decision quickly becomes very obvious.. You cannot borrow. You cannot use your credit card to buy a new refrigerator, so you do without. You very quickly realize this is not what you meant to happen. When the rent or the mortgage comes due, you cannot arbitrarily cut ten percent. Then you say: Well, we didn't really mean that; we'll have to exempt the rent (or mortgage) from the across-the-board cut. Then the pile of bills that are set aside grows, and the amount that has to be cut from the rest to get to your goal increases.

That is roughly where we are with Gramm-Rudman-Hollings. Fortunately, the conference on Gramm-Rudman-Hollings exhibited great wisdom. They designed an opportunity for all of us to see first hand how sequester really works -- and with relatively small numbers. Next week the FY 86 sequester order will be made public. I think we will see very quickly that government is no different from a family. We can all watch for the "Hey, wait a minute" reaction. "We did not mean to cut air traffic controllers when we wrote this law. We did not mean this; we did not mean that. Let us exempt all these very important priorities."

I think we probably can get through FY 86 and learn a lot about the Gramm-Rudman-Hollings process, but I do not think we can get through FY 87. In FY 87 it would generate a set of budget decisions that absolutely nobody wants, not the President nor hardly anybody in the Congress. The hope is, as we have said several times today, that this realization will shock us into leadership and compromise. I believe, as many have said here, that there is a possible compromise which, if the President signed onto it, he could bring to fruition with relatively little difficulty. If Gramm-Rudman-Hollings does not shock the participants into working out an alternative, there are I think only two possibilities: we repeal it, or we go on with the deadlock and ignore it. My hope, like everyone else's, is that next week's sequester exercise will be followed by the realization that the budget problem is not really so hard. We can work it out. Then we can turn to the other important issue: simplification of the existing budget process.

BUDGET PROCESS AND BUDGET BALANCE

Discussion

Panelists:

William Lilley III, Corporate Affairs Senior Vice President, CBS, Inc.
 Susan King, Producer, Cover Story, Channel 4 NBC (Washington, DC)
 Richard Mooney, New York Times

BILL LILLEY: Nobody told me this was going to be on C-Span. I would like to ask Connie and Rudy two questions that touch on the intersection of their lives and my business, the media. Rudy made what I think is a correct point back in the seventies, you could not get the press to cover the budget process. The first and second budget resolutions -- which we always passed at night -- were page 64 material and certainly never made the evening news. It was very difficult to get members of Congress to serve on the Budget Committees since -- except for some of these gentlemen on my left -- it was regarded as a kind of a danger zone. That is not true today. Budget resolutions and debates are major media events. The public understands the outcome of the events. You could question whether they understand its meaning, as Alice and Rudy noted, but they certainly follow the outcomes. My question is why and where have the politicians failed in educating the media and the media in educating itself as to two of the critical elements that go into determining the outcomes: (1) the timetables specified in the process, and the ability to avoid the discipline of meeting the targets by missing deadlines; and (2) the whole question of economic assumptions that Rudy talked about.

REP. CONNIE MACK: My first reaction is that I am not so sure it is the budget process that has caused the media to cover what is going on in the budget. From my viewpoint, the media is covering the budget debate because of the size of the deficit. As to your questions: We have failed to educate the media on the process because frankly, I think most members of the Congress know very little about the process.

You ask how we are able to get away with avoiding our responsibilities on timetables. The Congress for years has been able to waive all kinds of rules and deadlines, and the media, along with the general public, has always shrugged as if to say, "Well, that's the way the Congress reacts." So no one really raises it as a big issue.

DR. RUDY PENNER: I really think the media does a much better job of covering the budget and economics generally than it did in the early seventies when I first came to Washington. However, Bill, I think the print media has improved a lot more than the electronic media.

I think one of the problems is fairly simple. Budgets deal with numbers, and numbers are very hard to explain, especially when those numbers involve billions of dollars and none of us really understands what a billion dollars is. The single most important fact about our Federal budget is one that is not very well known: How much of the budget is devoted to very few items -- defense, social security, and

interest on the debt. We only talk about that little portion, the nondefense discretionary category that has all the other things in it.

We are doing a little better at getting the point across that if you do not deal with defense, social security, and medicare, it is very hard to imagine major changes in the path of spending. Nevertheless, even given that the issue involves numbers and proportions, I still believe that the electronic media could do a little better at using the ingenuity at their disposal to come up with graphics and animation to make the story clearer. It may sound corny, but I think it could be very important. Indeed, I think the President often does a better job with his graphs than you do on the evening news.

DR. ALICE RIVLIN: Let me add a word about the timetable. I think we fail to meet the timetable not because Congress is lazy, but because the timetable is impossible. The number of stages and things specified in the budget process cannot be done on time. In part that lesson has been learned. The second budget resolution died in Gramm-Rudman-Hollings. But the original time schedule could never be met.

If anything, I think the media has given this too much attention, often saying Congress failed because it did not get the budget resolution done by May 15. Well if Congress gets it done by June or July, for heaven's sake, it did rather well. Last summer when they did stick in there and finally finish, I think both the Congress and the media failed to say what an achievement it was. Congress was so exhausted they just went home and said "Well, we did it!" and the media did not pick it up at all. That was a mutual failure.

CAROL COX: Rudy alluded to the difficulty of explaining numbers and explaining the budget process. A little bit facetiously, I am led to comment that any medium that manages to explain the NBA or NFL playoff systems could, if it chose, explain the budget process better than it does.

BILL LILLEY: Carol, I think we are talking ratings here.

CAROL COX: But you asked how you could do it better, not why you aren't doing it better. If you agree that the issue is as important as most of the people in this room today have suggested, and if the media is the major source of information for the American people who ultimately have to choose who makes these decisions for us, then it is worth investing a little more time and resources to find a better way to explain what is going on in the budget process to the folks out there in the country.

REP. CONNIE MACK: Bill, you asked why more attention is not given to economic assumptions. If my memory is correct, the process has functioned in such a way that the assumptions are pretty much established by the CBO and the Budget Committees. During most of the time I have been on the committee, there has been very little discussion at the committee level itself. Perhaps we could put more emphasis on the question of assumptions, because the rate of economic activity in the country has a significant impact on whether there is an increase or

decrease in the size of the deficit.

ROY ASH: What about the idea that before Congress considers spending and revenue issues, it would specifically address the matter of economic assumptions to be used in the budget?

REP. CONNIE MACK: Frankly, I think that makes a great deal of sense. I would like to see us spend more time on the economic assumptions.

DR. ALICE RIVLIN: As a veteran of the battles of early 1981, I cannot believe this conversation. For those of you old enough to remember, there was a very media-intensive battle about the economic assumptions that went into the "rosy" scenario. Remember, that was the Administration's forecast. The CBO had a less rosy scenario, although as it turned out, a still too rosy one.

BILL LILLEY: Let me ask any of the panelists: The electronic media covers events. That is a fact of political life; that is why a politician has a press conference if he is going to announce something. Is there an event in the beginning of the process that focuses on the economic assumptions and the difference between the President's OMB and CBO?

DR. RUDY PENNER: Well, there was quite a debate in the Senate this year as to whether the budget process would use our assumptions or the Administration's. There was an explicit decision to use the Administration's as the foundation for the process this year. I think there usually is some debate about it. There was not much in the House this year; it just accepted what the Senate sent over. There have been all sorts of combinations. I even remember one year when there were four rattling around: The Senate, the House, the CBO, the Administration. It certainly is discussed; I even think it is covered, but maybe I watch it too closely.

BILL LILLEY: If the politicians that are running the process want publicity, why don't they structure an event in the beginning of the process to sharpen the focus on the assumptions? What are the political reasons to avoid doing it?

REP. CONNIE MACK: Bill, could I turn the tables a little bit and ask a question? Maybe you could give us some input as to how we could structure an event that would create an awareness or a willingness on the part of the media to cover it. What would have to happen in order for people to be interested in whether we make the statement that we are going to have 4 percent real growth or 3-1/2 percent real growth?

BILL LILLEY: From what Alice and Rudy are saying, it seems to have intensified since my day. If you have different sets of assumptions which are basically politically driven, you have a potentially confrontational type event. The media love to cover any inherently confrontational event. If these things were explained, they would make an awfully good educational media event. The press would like to cover it, and it would be something good for the electronic media.

DR. ALICE RIVLIN: I think there are media events; they are called hearings, and the C-Span audience out there knows all about those. They are willing to sit through them. But what happens on the evening news is that there is a two minute clip of one part of this intensive debate, and that is all the evening news can afford to devote to it. I think that it would take a program explaining with graphs a la football what this is all about. That would take some more resources.

SUSAN KING: I did know we were going to be on C-Span; and NBC, like CBS, does not allow you to appear on anything. But of course I am from the network of Miami Vice, and when they heard this was going to be 24 hours of budget and deficit talk on C-Span, they said no problem.

This is key to what we started talking about here. I am a daily reporter. I have a deadline everyday on some issue, and I have to figure out what issue to do that day. What I do is choose the issue that seems to be most important on a given day, then try to sell that to my editors or producers. Most often if I say, "I think we should do a budget story tonight," that is not what they want to hear. Remember: producers are looking for a story to capture the attention of the prime time audience. I pass this on to you because it is what reporters face all the time. A reporter may be terribly concerned and trying to keep up with a story he/she knows is important, but until it gets to the crisis point, editors tend not think it is so important.

The rating point is not so facetious. How many of you here turn every day to the evening and the 11 o'clock news because you cannot live without it? Probably a small minority. The irony is: the people who are most concerned about these issues are the people who would not live without the New York Times or the Washington Post every day; but they can do without me. So sometimes, we and our producers must have a different sense of the audience. I respect my audience; I am not always sure that the people I work with respect my audience.

Also, these issues are less an economic or number story and more a political story. The drama is in fact what is told. If confrontation is the real essence of the story, it is because of the human drama.

Part of the reason why the budget has become such a big story is because it is about the role of government, about what we are going to become in terms of our priorities. The question is, should government be spending money on the domestic front or not. Mr. Flavin almost brought us to that debate. Often the budget debate, which really is a proxy for that debate, confuses or even obfuscates the real issues.

Dr. Rivlin, you talked about budget reform and some of the elements that you thought should be in budget reform. The White House yesterday started leaking stories about the State of the Union, that it would have a more thematic approach than in the past, and the President would talk about something new -- budget reform. Last year it was tax reform; this year it will be budget reform and really changing the whole budget process. Do you think that is good to bring process reform into the debate right now as we face Gramm-Rudman-Hollings?

DR. ALICE RIVLIN: I think we desperately need budget reform in the sense of the simplification of the process that I referred to. I doubt that is what the President has in mind. I am afraid that any revamping of the budget process will be a diversion. What we need is to get the job done. We have all the processes we need to do that, and I would be very leery of launching into a great campaign to reform the process before we get the problem solved.

DR. RUDY PENNER: An aspect of Gramm-Rudman-Hollings which really has not been focused on very much is one extraordinary reform of the process, both at the macro level and at the micro level. We budget types for years have been trying to get all sorts of things on budget. Though we lost social security, which is not insignificant, we did gain the REA; and now all sorts of things that used to be off-budget are on-budget. Gramm-Rudman-Hollings contains an enormous number of reforms that a lot of people have been trying to get for a very long time. Of course, how they are all going to work out, we do not know yet.

SUSAN KING: I am wondering what you feel is most potent about Gramm-Rudman-Hollings. Is it the threat of sequester?

DR. RUDY PENNER: Yes, I think that the sequester itself is a very, very important threat, the basic point being that it is designed in an extraordinarily rigid fashion so you cut from every one of your activities proportionately. And as Alice says, that is not the way anybody would go about cutting the budget. Nobody would ever dream of cutting military bands by the same percentage as the strategic defense initiative, but that is what it does. So it is purposely designed to be very unappealing. The whole idea is that it will induce better behavior on the part of the Congress and lead to more rational results.

DICK MOONEY: As the 33rd speaker of today's 38 speakers, I am somewhat daunted. Let me start out with what Connie said about his first vote, because it seems to represent a real problem. In case it has not been made clear in our editorials, we think Gramm-Rudman-Hollings is a terrible idea -- start to finish -- and unconstitutional, too. It was done in great haste. Consider, at least, that the 1974 Act had some time and thought put into it. This one was pulled out of the drawer in August. Indeed, Phil Gramm may have thought about it a long time, but not many other people had.

I was disturbed that Connie would say, "Let's abolish the Budget Committee." It seems to me that the Budget Committee represents the focal point of the 1974 Act. There is no way that Appropriations, or Ways and Means or Finance, or all the authorization committees can take the overall view that is assigned to the Budget Committees by the Act.

I far more favor Alice's formulation, which might be a combination of Budget, Appropriations, and Ways and Means, though that sounds to me like a mini-Congress, possibly an unwieldy committee or at least an awfully powerful committee. I think Alice was pretty brave for mentioning it, but we are supposed to be starry-eyed. I did have one idea, and that is if Alice would agree to the name of the committee -- Budget, Families, and Children Committee -- then I could get Connie to

vote for it.

DR. ALICE RIVLIN: How about Budget, Family and Social Security Committee?

DICK MOONEY: Ok. Add grandparents and grandchildren too. No, I am fully in agreement with Alice on the streamlining, but I fail in line with John Rhodes in concluding it will not be done.

I want to mention something that Connie said in his prepared remarks, but had the good sense not to mention orally: the constitutional amendment. It has not been brought out much today, and that is good. I am not sure why I am bringing it up because it is such a bad idea, but I would only commend Connie. He has added a wrinkle that I had not seen. He wants a tax limitation clause in the balanced budget amendment, and I think that guarantees it will never be passed.

REP. CONNIE MACK: You can probably tell that I think the system is out of control. I am very concerned that we do something. Maybe the reason the constitutional amendment has not been talked about is that we passed Gramm-Rudman-Hollings, which establishes targets. It sets an amount that can be spent by the Federal government, so future actions could be similar to what would happen under a constitutional amendment, especially with one that has a tax limitation clause added to it.

DICK MOONEY: Let's go back to the matter of assumptions, because Rudy brought that up first in his remarks. The assumptions are a terrible problem, not to be resolved in any debate that I can imagine that puts Rudy Penner tail to tail with Beryl Sprinkel.

The Administration, as Rudy hints but does not say directly, inevitably has hopeful assumptions. They are not in the business of predicting recessions, at least not in even numbered years. They cannot, and they will not. I do not believe any annual economic report has ever predicted a recession. They all come by surprise. If you are in one when the economic report comes out, it predicts the end of the recession, but they never predict the onset. The Administration's estimates are going to be optimistic just because its posture has to be that the economy will improve and that Congress will accept its programs, which will have the predicted impact.

CBO clearly has established a better reputation for its projections, though certainly they are not perfect either. I tried unsuccessfully to pry out of Rudy just before this whether we are going to get one number or two on Wednesday. I am bothered by the role of the assumptions in Gramm-Rudman-Hollings.

Rudy, you said, and I am curious about this, that the Congress and the Administration had deprived themselves of the opportunity to choose their assumptions in Gramm-Rudman-Hollings because they have turned it over to you and OMB and GAO. Since OMB belongs to the White House, I do not think that is depriving themselves of any opportunity to make their assumptions. I do not know how it will work, but certainly my worst fears are that the Administration will inflate or deflate its estimates,

to cause the triggering if it wants to. It can use that number and use that projection to cause Gramm-Rudman-Hollings to be operative or not. What do you mean by depriving themselves? I do not think they are deprived.

DR. RUDY PENNER: Well maybe I did not put it very well. Right now, or prior to Gramm-Rudman-Hollings -- and indeed still, in the matter of formulating budgets -- the choice of economic assumptions is a very explicit decision which the Budget Committees discuss and on which they vote. Many times in recent years, they have chosen ours. Through the history of the budget process, as I said before, they have chosen all sorts of things; and indeed last year, they did not choose ours. They chose the Administration's. So they have an explicit choice.

Under Gramm-Rudman-Hollings for the purposes of triggering or not triggering the sequester, what you will get is averaging or blending of the economic assumptions of OMB and CBO. The net effect is like a blending. Literally nobody knows the outcome. You are right to suggest that there could be some gaming back and forth, but I think there are limits to the gaming, and I think that no one really knows exactly how they will come out. I do not know today exactly how they will come out. It is not a conscious choice in the same way that a committee now sits down and decides what they are going to use. I think that the important point to make about economic assumptions is this: what an economist would call trivial forecast errors lead to changes in your budget estimates that have enormous political significance; that is a very important weakness of this whole thing, and it is a very difficult point to get across.

I will never forget when I was at OMB under Jim Lynn. He had been bargaining all day with EDA to cut a \$100 million from their budget. I did not know this as I wandered in at night, saying Jim, "I'm sorry, we made a little mistake on the CPI; it's up a tenth more, but that will only cost us a \$100 million in the index." I had no idea why he went through the ceiling and shouted and screamed about economists and CPIs and all that.

There is a complete mismatch between the effects of the assumptions on those totals and the meaning of changes in the totals in terms of political pain as defined by the politician. I think if we can just get across that fact, it will be a big accomplishment. It will always lead to extreme difficulty in negotiating a budget, and I do not really have a good answer, even though I spend a lot of my life thinking about what a good answer would be.

DICK MOONEY: You say there may be a little gaming with the numbers. I know that your model is not limited to a single model. But who on earth, except Beryl Sprinkel, believes that the economy is going to grow 4 percent in the coming year?

DR. RUDY PENNER: Oh really, quite a few people. There is an extraordinary diversity of forecasts right now, some ranging all the way from booms that make Beryl look modest to forecasts of outright recession. That is economics. You can find almost anything out there.

RICK BRANDON: Jon Fuerbringer and Helen Dewar can vouch for the fact Lawton Chiles tried to get attention on overly-optimistic economic assumptions. That was during a very simple dispute, as Rudy says, over the amount of pain to come out. We felt that the Republicans were using overly optimistic assumptions to downplay the amount of pain. I say this not just to bring up past history, but to highlight how bad an idea it would be to force more votes on economic assumptions.

Most people are not aware that there is provision in the Budget Act right now for us to put the economic assumptions not in the report, but in the budget resolution, and bring them up for floor debate. That provision was put in as part of the Humphrey/Hawkins Act. The expectation of proponents of that provision was: if Members had to vote on the unemployment rate, they would make budget decisions in favor of high enough spending for public jobs programs to get the unemployment rate down. When you think about it, it is very simple: If you ask Members of Congress to vote on seven percent unemployment versus four percent unemployment, I will bet you all know which will win every time. The same is true of four percent real growth versus two percent real growth, high versus low interest rates, etc.

On the floor of the Senate then-Senator Schweiker once actually offered an amendment that reduced the budget across-the-board by \$15 billion dollars simply by reducing the interest rate assumption, without changing any expenditures. I think economic assumptions are very important; they affect the amount of pain the Congress will take.

BILL LILLEY: Richard, on behalf of the networks, I never thought that we would want a floor vote in the U.S. Senate just to provide us a media event.

JOHN RHODES: I guess my question will probably be directed to either Alice or Rudy. I was on the committee that set up the budget process. I do not take any great amount of pride in it, except that it had to be done, and we did it. We knew it was flawed, but we did the best we could given the fact that every committee chairman in the House and Senate was against it. We had some problems to work out, and one of the main ones was the timetable. We made several assumptions about that, too. One was that by having each party meet to organize right after the election we would be able to start the next Congress about a month earlier than it now starts. This should have worked, but about the same time the Democratic caucus decided that it, not the Speaker, would decide committee assignments. That cost us a month, right there.

So the original timetable did not work, and probably never will. It still is necessary, in my opinion, in order to keep some decent control to have something happen at a certain date. Originally, the date was to be May 15 when the first concurrent budget resolution was to have been adopted. Considering the fact that Congress does not start at the first of January, May 15 probably is too early; June 15th might be better. Nevertheless, if indeed there is a budget in place on June 15 or whenever, then the Appropriations Committees can go to work: allocations can be distributed to the subcommittees, hearings held, markups begun, and the process proceeds. Otherwise, you have a situation like today in

which not very many appropriations bills have been adopted by the time the fiscal year begins.

I would like a reaction to an idea. The only way to get Congress to do something is to make the alternative an unthinkable result. I have one in mind which to most members of Congress would be unthinkable. If by June 15th, the concurrent budget resolution has not been adopted, then the President's budget would become the congressional budget, and from then on you would proceed with the President's budget as if it had been adopted by the Congress.

Let me also make one comment on something I gather you proposed, Connie, when I was out of the room, that is to abolish the Budget Committees. I certainly would not want that to occur. If the budget process has a genius, it is that it does set up a mechanism whereby the Congress, acting as a whole, can force committees which are recalcitrant to act. You do that, of course, by bringing a resolution directing specific results out of the Budget Committee and taking it directly to the floor. Alice, I suspect you are thinking my idea will never happen; you are probably right. Nevertheless, the committee that set this up intended that there would be a mechanism to make certain things happen if a majority of Congress wanted them to happen. I really feel strongly that while the process needs overhauling, it is good and should be retained.

DR. ALICE RIVLIN: John, I think we have adopted your idea. It is called Gramm-Rudman-Hollings. Inherent in Gramm-Rudman-Hollings is that if the Congress does not act, then there is an automatic action, and it is an unthinkable one, probably more unthinkable than any Budget Committee or any president would ever put together.

A note on the time schedule, though: Gramm-Rudman-Hollings does change it; and it moves it the other way. It moves the budget resolution forward rather than back to June 15. I think it is going to turn out to be very difficult to get a budget resolution by the middle of April. I am for having realistic target dates, and I think we will have to find out, in using this process, whether it is doable or not. We found out the other one was not.

JOHN RHODES: Actually, Alice, there are several differences, I think. I doubt that Gramm-Rudman-Hollings is constitutional, unless the Supreme Court can find some way to square it with the Chadha case. If they can, that is one thing. If it is unconstitutional, I submit to you that something like I mentioned, having the Congress do it to itself probably would be constitutional and would have about the same effect as Gramm-Rudman-Hollings.

DR. RUDY PENNER: I think there is something else to keep in mind about time schedules. In the purest of economic theory, when you are putting together a rational budget, everything should be traded off against everything else so that you think about the trade-offs between the number of forest rangers and the national parks and the amount of small arms munitions we store in Europe and so on. There are over a thousand appropriations accounts. That means there are over a million

possible trade-offs that one could think about. Well, one cannot think about that many. It is beyond human comprehension. There is no way that you can deal with each one of those decisions every year. Thus by its very nature, the budget process has to be arbitrary in truncating the number of decisions that you focus on in any one year. The number of trade-offs is so different, that while you could make a good case for two-year budgeting, I do not think it would help that much. We just have to recognize that we cannot deal with everything every year and try to do a little better on the schedules we do have.

DR. NORMAN ORNSTEIN: One comment and a question. The comment has to do with the coverage of this process. A colleague of mine, Michael Robinson, and I just finished a fairly comprehensive study of how the networks cover Congress; it appears in this week's TV Guide. We looked at every evening news broadcast in the month of September, a month when Gramm-Rudman-Hollings was just coming to the fore, when all the questions were being asked about whether we wanted to go in this direction, what would be done, etc. There was almost no coverage of it. There was one issue covered extensively in Congress during that month on all three networks: the question of rock lyrics and pornography. That issue got far more coverage than any issue that relates to this process.

The question has to do with reforms in the budget process and the two-year budget. Think back to our discussion of economic assumptions and the fact that even if assumptions are made in absolute good faith, they still are as imperfect as Rudy suggests.

We now have a one-year budget cycle where we are making budget assumptions 21 months in advance, and we spend virtually the entire budget year worrying about how to adjust the budget to fit the new data that we have coming about those assumptions. The two-year budget is getting a lot of attention because theoretically it would enable us to spend one year on the budget and the next year worrying about other things. Then we would have assumptions set 33 months in advance. Isn't it likely that rather than solving the problem, it might create new problems, that we would spend even more time tinkering with the assumptions over the 33-month period and, even assuming good faith, making some decisions on longer-term assumptions that would have to be altered even more dramatically later on.

DR. RUDY PENNER: I think that is right; I think you would spend a lot of time changing things. On the other hand, I do not know why we appropriate for some items every year: the mint, for example, and already existing binding contracts. Things like the U.S. mint and the CBO, for example, I think could be dealt with every third or fourth or sixth year.

DR. ALICE RIVLIN: It may be a measure of lost faith in the fine tuning of the budget, but I think it is ridiculous to change most of the budget because the economy changes. The budget should be set for several years. There are very few things you can think of that really need to be fine tuned to changes in the economy, and most of them, like unemployment compensation respond automatically. If you had a two-year budget, and a sudden sharp recession came, you could consider either tax changes or a

small number of programs that might respond on the spending side to a recession. But you really should not change the Civil War monuments appropriation or anything else in those circumstances. It is silly.

JACK CONWAY: Mr. Penner, you took your snapshot of the FY 1986 budget today, based on congressional action last session. You take your snapshot of the FY 1987 budget on August 15. What will you use as the basis for your snapshot if Congress has not completed action on regular appropriations by that time?

DR. RUDY PENNER: Well, we can no longer use a Kodak camera. The law is very precise about what we use under those circumstances. We use appropriations actions if they have been completed; we use continuing resolutions if they are for 12-month periods. If there is no 12-month continuing resolution, we use last year's appropriation level.

The law is straight forward on what the baseline is; the question is what the incentives are going to be. That is a more difficult question to answer because it is so complicated. There are the good incentives that we talked about earlier today, i.e., that this looming sequester will cause everybody to do good things. But there is the other side, the bigger your base is before the bad thing happens, the better off you are; there is no doubt about that. So there is that incentive as well.

DR. ALICE RIVLIN: There is the additional point that there is a specific numerical goal that has to be reached. We play this game of how much have we saved over the last several years, but there was never an end point that had to be reached; that does change the game a lot. You jockey for position within the total by raising your baseline if you can, but in the end, in 1987, you have to get to \$144 billion somehow. And that is the new element.

REP. CONNIE MACK: In other words, there is a built-in consequence. They can play the game for a certain length of time, but there is going to be a day of reckoning. You are right, if a person plays the game cleverly, he may protect his program a little bit more than someone else. Let me just, if I could, build on that point about arguing. In the three years that I have been here, we have spent a huge amount of time arguing either Democrats versus Republicans or Senate versus House or executive versus legislative. Meanwhile, spending continues to go up. Therefore, I think one of the important changes is a very subtle one: on a certain date, if there is no agreement, spending is cut.

NEWT GINGRICH: As you know, I am a very big fan of the two-year budget concept, and I think we desperately need to get to something like that. But I was struck by Rudy's point that there are a thousand accounts, which means that if you are actually trying to micromanage, as you put it, how many more forest rangers versus how many more small arms munitions stockpiled in Europe, you end up with a thousand times a thousand choices. What really struck me, and I think it goes to the heart of what we are avoiding as a Congress, and in a sense as a country, is that by definition, you cannot do that. I describe Gramm-Rudman-Hollings as proof that we wanted to balance the budget in the worst possible way, and we might do it. This is all evidence that we are only

capable of being a clunky, clumsy institution, and that we therefore need to make relatively large classes of decisions that are stable over a relatively long period of time and recognize that you sort of coerce the executive branch crudely, not subtly. That probably means taking an awful lot of power out of the subcommittees. The creation of the congressional subcommittee system maximizes the desire of each subcommittee chairman to have all sorts of trivial power, which they can only express if we make all kinds of micro decisions.

ROY ASH: Would you put that in reverse and say, that is why they do deal with such trivial matters because it is the way they exercise power?

NEWT GINGRICH: Yes, I think that a subcommittee chairman today or a subcommittee staff director today has far more real power over what are small issues of this nation. These are trivial decisions for the nation at large, but they so absorb us now, they so distort our time and deny our ability to face the big decisions, that they are draining away our capacity to govern ourselves in terms of real issues.

DR. JAMES BUCHANAN: I want to respond to something that Mr. Mooney said and say something about the constitutional amendment. I may be one of a very few here today who is ambivalent about Gramm-Rudman-Hollings because it is not rigid enough. It does not bind enough. I think the problem with Gramm-Rudman-Hollings is, one way or another, it will not be enforced. I think there is some chance a constitutional amendment might be somewhat more constraining.

With all due respect, I think that most of this discussion today has simply been spinning your wheels. You have been criticizing the President because he has not exerted leadership on this; you are criticizing Members of Congress; you are saying all we need is to have responsible leadership, and everything is going to be all rosy. Let me submit, that is absurd. Look at the members of the House and the Senate. These are responsible people. The problem is not the people that are involved. It is the structure of the decision process. We have lost the basic underlying sense of matching up the costs and the benefits.

Now, Congressman Gingrich got to the right point this morning. Up until the middle of this century, we did have a mythology that in fact amounted to a constitutional restriction on budget unbalance. Now that mythology is destroyed. You cannot simply invent and impose a new mythology. You do not just sort of lay on the old mythology. The best substitute for it is a constitutional amendment. Until you do that, you are going to have the same thing; you are not going to get out of this problem.

DR. ALICE RIVLIN: I do not think my esteemed colleague should go unanswered here. I for one am not enthusiastic about a constitutional amendment because I think the mythology has died the right death. It is not that we should always balance the Federal budget, it is that we should use credit responsibly; at the moment we are not. I do not think you can write that into the Constitution. Once you try, you make all kinds of exceptions. As my friend Charlie Schultze says, you write algebra into the Constitution, and you end up with a much more complicated

thing which nobody can understand and which they would again find a way to avoid because it is really not part of our culture.

CAROL COX: I cannot let this discussion pass without pointing out that what Newt Gingrich calls mythology we called a norm in describing this symposium. I, for one, do believe that the norm of budget balance operated very well for a very long period of time in this nation to constrain the public policy process. Politicians did not make decisions that otherwise would have been very attractive to them because there was a general and widespread acceptance of the proposition -- call it a mythology or a norm -- that it was inappropriate for the Federal budget to be out of balance very much or over a long period of time.

I do not believe you can write norms into statutes. I do not believe you can write them into constitutions. I think the behavior of States which have balanced budget constitutional amendments is pluperfect proof of the fact that politicians will do what is politically desirable. You have to have very broad acceptance of some basic proposition, a proposition so ingrained in the body politic that the politicians ignore that norm at their peril. That is the only really effective constraint. That is what democratic institutions are all about.

Given the discussion last night and today about the possibility, even probability, that the Congress and the Administration may put their energies to work finding ways to avoid the constraints of Gramm-Rudman-Hollings, I would be enormously concerned about their writing such constraints into the Constitution -- then putting their genius to work trying to find ways to avoid the constitutional constraints. I think that would be very unhealthy for the democracy.

I do not think anyone in this room wants more than I to see the budget move back toward balance. If I thought a constitutional amendment would produce that end, I would seriously reconsider what I think about it. The question is: Have we, as John Rhodes asked last night, abjured the norm of budget balance? If we have, what in the world will take its place to constrain the public policy process in this country? If we do not find some broadly accepted norm to do that, I do not think anyone can write laws or amend the constitution to accomplish the same end.

ROY ASH: I am certainly glad we got to this part of the discussion before the day was over. We return full circle to where we began.

REP. JIM SLATTERY: If I could, I would just like to interject with an observation from my four years in the Congress. When I came to Congress there was an awful lot of emphasis on what was then called Reaganomics or supply-side economics. There were then people in the Congress saying, "Why are you worried about deficits? We are going to grow out of them. Don't worry about it." I can assure you that I do not hear many people saying that today. That attitude, in my judgment, has substantially changed in the Congress. Maybe we are in the process of swinging back -- returning to the mythology, if you will, to use a term that is been used here today.

A year ago the CBO estimated that by 1990 the deficit would reach

some \$300 billion, if not more. Now we are looking at CBO projections of somewhere in the neighborhood of \$120-150 billion, assuming implementation of the budget resolution coupled with a good economy. Nevertheless, substantial progress has been made; we should be careful how much we flagellate ourselves on this whole question. The good news is that maybe we are in the process of returning to the mythology.

WENDELL BELEW: I would like to follow up on a point that Jim Slattery made. I do not think that we ever abandoned the mythology of balanced budgets. In 1981, if you recall, the budget that Congress adopted called for a balanced budget by 1984. The budget in 1981 was based on unrealistic economic assumptions, particularly interest rates and growth. It assumed savings that simply were not realistically achievable. How does one confront that notion? How does one confront the problem of having a budget document out there that you know is unrealistic? A member of the press really cannot say the emperor has no clothes. You cannot say these economic assumptions do not make sense. In my view, that is a large part of our problem. How could we have avoided getting into that problem in 1981? You cannot run a headline, and it seems to be difficult to write a story saying, "President Reagan presented today a budget that projects a balance in 1984. These are phony numbers." You cannot run a streamer in the evening news under the President of the United States saying these numbers do not add up. Even Alice Rivlin, who in 1981 was CBO director, may have thought the economic assumptions underlying the budget were crazy. But CBO Directors do not say: "The President's economic assumptions are absolutely nuts." One never really knows which economic assumptions are absolutely nuts. In 1981, no one had any experience with this supply-side scenario.

BILL LILLEY: Wendell, I think the answer goes back to what Connie and I were talking about an hour or so ago. Whether it is the President or the House and Senate Budget Committees' three-year projection or a company's internal three-year projection, there is always the hockey stick aspect to how things are going to be in the out years. I think that is sort of a fact of planning life or budgeting life. And unless the politicians want to take that on as important, it will not become an item for coverage by either print or electronic media. I think that it has to become a politically valuable issue for it to become media valuable.

DICK MOONEY: Wendell, I think we are a little less slanted than you would be in reporting these numbers. Our second paragraphs usually say, "these are estimates" or "these depend on debatable estimates that the economy will grow by four percent," that kind of thing. From the forecasters' and estimators' point of view, I think it is tough that you are asked to come out with a single figure. The very best you can possibly do is say the deficit will be within a range of \$180 to \$220 billion. Ranges are all that really are reliable. We hound you, everybody else hounds you to be more specific. But I think that the ultimate laugh is when you put decimal points in your estimates. You say that the deficit next year is going to be \$187.9 billion.

Roy Ash: We must close now. We can be specific. Our appointed 2.75 hours have expired.

BROWSER'S GUIDE

Session VI

Turning the Tables: Reportage of Budget Issues

In this session the floodgates opened. Not surprisingly a great many participants in the budget debate had a great deal to say about press coverage of that debate -- not all of it complimentary.

Several consistent currents ran through the discussion: concern about the effect of forcing everything into 90 seconds for television; the difficulty of conveying in daily reporting the sense of what is really happening in a months-long debate; the fuzzy line between making an issue real and telling horror stories; the clash between appearance and reality; the fuzzy line between politics and budget beats.

Everyone except Paul Duke seemed somewhat dissatisfied with the job being done -- but the elements of dissatisfaction varied. Joint Economic Committee Chairman David Obey wanted more reporting on economics as opposed to budget; Representative Delbert Latta wanted fewer daily progress reports and more silence while participants in the budget debate are trying work out compromises. Some reporters were frustrated by editors or producers who still see the budget as a narrow numbers story rather than as a debate about national priorities. A number commented on the contrast between appearances and reality, something difficult to report -- especially without being accused of editorializing.

Most of the non-media participants saw the media's role, at least in part, as education. Many media participants objected vehemently to that concept. Perhaps the verb "to educate" means different things to different people. Clearly, everyone agreed it is important for the media to provide a context within which the budget debate can be better understood.

Most political players saw the press as actors in the process -- not merely as observers. This is not a sinister view of the world. In any large democracy the media provides a link between the electorate and the elected. What the press says and how an issue is reported influences public perceptions of political issues or actions. For instance, a vote that gets headlines is perceived as more important than one reported on page 20 of the newspaper. And those perceptions effect future actions. When the emphasis in the evening news is on Congress' voting to cut the deficit, they are more likely to act similarly in the future than if Dan Rather, Tom Brokaw, or Peter Jennings dramatizes the effects of deficit reduction by focusing on the cost to old folks, national defense, education programs, or taxpayers.

Some members of the media seemed uncomfortable with this role, either because it seems larger in the budget debate than in other issues or because they previously had denied its existence. This effect of media coverage was, however, the focus of much discussion in this session.

CAN WE TALK HONESTLY ABOUT THE BUDGET?

by

Owen Ullmann

January 11, 1986

A wise, senior colleague of mine has a basic rule about the nature of newspaper journalism. "Editors will let you tell the truth," he explains with a devilish grin, "so long as you don't put it in your lead." To a large extent, he's right. Those of us who cover Washington for the news columns spend much of our time reporting what others -- usually government officials -- say has happened rather than what we, as impartial observers, perceive has happened. Frequently, what they say is consistent with what we conclude, but often there is a conflict between our sources' words and our perceptions. In those cases, what they say normally becomes the thrust of the story, which winds up on the front page if it is important enough; what we have concluded to the contrary gets inserted lower down in the story, or it is saved for a "news analysis" or column that may be printed, "buried" is how we call it, deep inside the news section.

This has been my rueful and amusing experience during the five years that I have covered the Reagan Administration's handling of the federal budget, first as an economics writer and later as a White House correspondent. Imagine some of the budget stories that would have appeared in print, were it not for my colleague's rule. In 1981, instead of headlines proclaiming, "Reagan to Balance Budget," we might have seen, "Reagan Demands Tax Cuts and Big Boost for Pentagon Even if Deficit Soars." In 1982 and 1983, instead of a constant stream of stories to the effect of, "President Vows to Attack Deficit," the headlines might have said, "White House Struggles to Put Best Face on Budget Problems While Letting Deficit Grow." During the campaign year of 1984, Reagan's claim that, "U.S. Economy Will Grow Its Way Out of Deficits; Painful Choices Unnecessary," could have been written, "President Determined to Keep Deficit Problem Hidden Under Rug Until After Re-Election." And the budget story of 1985, "Reagan Signs Bill to Balance Budget in 1991," might have appeared as, "President Bucks Deficit Problem to Successor."

The federal budget may be the most talked about and written about subject in official Washington, but rarely is it discussed in the honest and straight forward terms that would help the average, interested citizen understand the nature of the problem and the realistic solutions available.

True, the budget is enormously complex, the numbers are incomprehensibly large, the congressional budget process is arcane even to those in politics or journalism who are supposed to understand it, there is a broad disagreement among the experts about the economic dangers of deficits and all the numbers are premised on predictions about the economy's future that rarely prove correct. As a result, there is a pervasive belief in Washington that the day-to-day saga of the budget is

an "Inside the Beltway" story, that nobody in Real Life America cares about the details that fill the news columns of the daily press. (One of my editors once bet that I could not find a single reader, other than my mother, who read one of my budget stories from beginning to end. I declined the wager.) This belief that the public at large is tuning out the budget details, I suspect, emboldens the players to manipulate the numbers, use political hyperbole, and resort to other less than honest tactics to achieve their objectives.

Nevertheless, public opinion polls consistently show that people are very concerned about the federal deficit and want it eliminated. Moreover, I have always assumed there is a sizeable minority of politically informed and interested people out there who try to follow the budget issues and want their elected representatives to take responsible action. Yet, as politicians, economists and journalists, we are letting down the public. Politicians give lip service to budget balancing while pursuing other objectives they believe are more important; economists keep making predictions about the dangers of deficits that do not come to pass, and journalists are busily reporting what officials and experts say as established fact at the expense of a healthy skepticism about the diagnosis of the problem and the prescribed cure. A brief history of the last five years from my perspective of covering the Reagan Administration underscores this unfortunate trend.

When President Reagan first took office in 1981, the political, economic and journalistic consensus was that budget deficits were evil and had to be eliminated once and for all. Of course, there shouldn't have been a deficit to eliminate; you will recall that the year before, Congress had taken the highly publicized action of writing a balanced budget for fiscal year 1981. Instead, an unexpectedly deep recession in 1980 produced a hefty \$58 billion deficit for 1981, proving correct the critics who had charged that a grandstanding Congress had merely balanced the budget on paper.

Reagan proposed a very unconventional way to eliminate the deficit, but his reasons for opposing deficits were quite conventional. Indeed, the conventional wisdom was that deficits were evil because they produced high inflation and high interest rates. This cause-effect relationship became an uncontested fact in the news media and helped fuel the public support for a balanced budget. On the strength of his claim that his program would balance the budget by 1984, Reagan won passage of a controversial package of tax cuts, domestic budget reductions and increased defense spending. Before 1981 was over, however, it became clear that instead of heading for lower deficits, the government had set on a course toward higher deficits.

The deficit began rising to record levels in 1981 because of a severe recession triggered by the tight monetary policy imposed by the Federal Reserve Board to control inflation. Monetary policy had remarkable success in lowering inflation. What had happened to the deficit-inflation link? The Reagan administration, now that it was stuck with the deficit as its own, suddenly turned revisionist. William A. Niskanen, then a member of the President's Council of Economic Advisers, created a brief uproar in December 1981, when he declared at an economics

seminar: "In general, concern about the deficit has been misplaced. There is no direct or indirect connection between deficits and inflation." He went on to say that the notion that deficits raise interest rates "is just not supported by the evidence."

Niskanen had made his novel argument in the wake of the controversy over Budget Director David A. Stockman's published admission that the Administration's budget-balancing plan was based on shaky economic assumptions that did not come to pass, and that the program was thrown further off track by too big a tax cut, too big an increase for the military and not enough domestic cuts. Stockman would spend the rest of his tenure trying to correct these unplanned results by pushing for further domestic cuts, reductions in defense spending and tax increases. But he was thwarted on all three fronts either by the President or Congress or both. Despite some marginal successes, he resigned leaving as his legacy a record \$211 billion deficit for fiscal year 1985.

Reagan has never abandoned his opposition to deficits, he just has been unwilling to make their elimination a top priority. As a result, he holds the distinction of presiding over annual deficits that are triple the record deficit prior to his presidency. Reagan also has allowed the national debt to double to \$2 trillion in the less than five years he has been in the White House. Yet, even though his public words continue to condemn the deficit problem, his actions have demonstrated clearly that he is willing to accept these fiscal results as the necessary price for preserving his military buildup and his 1981 tax cut.

Budget analyses prepared by his own administration have shown that Reagan's proposed savings on domestic spending would have been fully offset by higher military spending had Congress given him all of the budget increases for the Pentagon that he had sought. Moreover, Reagan's willingness to tolerate large budget deficits has fueled a dramatic rise in federal interest payments on the growing national debt. As a result, federal spending as a percentage of the national economy is higher under Reagan than at any prior time when the nation has been at peace. Nevertheless, the President accuses Congress of being the big spender and champions himself as the true budget cutter.

To try to make the reality of record budget deficits compatible with the President's budget-balancing rhetoric over the past four years, Stockman had the unpleasant task of minimizing the problem through sleight of hand budget techniques. Each year, he would produce a budget plan that showed a declining deficit in future years even though his private estimates showed widening deficits. With full White House approval, Stockman would accomplish his public mission by exaggerating savings and using optimistic economic assumptions. The proposed budget for fiscal year 1983 relied on inflated "management savings" and a dubious plan for shifting federal programs to the states. Within the Office of Management and Budget, the document became known as the "Blue Smoke and Mirrors" Budget. The following year, the White House was able to show the deficit on a downward path only by including a "contingency tax" that the president never seemed willing to support.

Preparation of a 1984 election year budget (for fiscal year 1985)

proved ticklish. For political reasons, the White House did not want to call for any controversial budget cuts, so it relied instead on an optimistic set of economic predictions that were defended with the perverse logic that this good news economic forecast would come about if Congress cut the deficit by more than the administration was willing to propose. For the rest of the year, Reagan would campaign around the country arguing that economic growth and elimination of budget waste (which he did not identify) would be enough to balance the budget in the future. All the while, Stockman was working quietly preparing a list of what his people called "draconian" budget cuts that would eliminate or curtail dozens of programs long popular with middle-class voters. Less than two months after his re-election, Reagan embraced those cuts as his budget for fiscal year 1986.

Now, the President has signed into law a bill that promises to balance the budget by 1991, but I have to wonder whether he would find a way around this legislation if forced to support tax increases and military budget cuts to lower the deficit. I am skeptical of the President's commitment to a balanced budget because of his track record and the political opportunism the White House saw in the Gramm-Rudman-Hollings legislation. It seems that partisan politics, not sound budget policy, was uppermost in mind when the administration decided to endorse the bill. One high ranking White House official explained to me shortly after the bill was introduced that the administration had been dreading the political embarrassment the Democrats would cause for Republicans when it came time to raise the debt ceiling above \$2 trillion. The budget-balancing bill, however, changed the situation overnight by allowing the Republicans to throw their opponents on the defensive, the official continued. I concluded from that interview that the White House viewed the legislation as just another political gimmick for showing a balanced budget in the future -- this time three years after Reagan's term ends.

Although the President's words about eliminating the deficit have been inconsistent with his actions, he has been able to get away with it for two principal reasons: Congress has been just as inconsistent, and the long predicted economic calamity that is supposed to result from the deficits has yet to materialize.

Members of Congress are always decrying the deficit, yet when it comes to taking concrete action, there always seem to be more important considerations. Congress is afraid to touch Social Security for obvious political reasons. Major tax increases have been ruled out for both political and ideological reasons. Domestic spending cuts sound good in the abstract, but when it comes to specific reductions in programs that members can trace to constituents -- particularly politically active ones -- the budget cutting fervor cools. Even critics of defense spending find a soft spot for the Pentagon when faced with the possibility of closing military operations in their home states or districts. There also are members who are as determined to preserve social-welfare programs as Reagan is to preserve his defense buildup. The few honest politicians who have backed up their anti-deficit rhetoric with a willingness to take unpopular actions have been reduced to throwing their arms up in disgust and bemoaning the political impasse.

Reagan and Congress have been able to avoid dealing with the deficit because there is no economic crisis and no clear data linking the deficit to existing economic woes. For years, the deficit has been blamed for just about every economic malady including high inflation, high interest rates, low business investment, economic stagnation, a strong dollar and the big foreign trade deficit. But during a three-year period of record deficits, we have observed a sharp drop in inflation, a steady decline in interest rates, increased investment, strong or moderate economic growth and, recently, a drop in the value of the dollar and a surge in stock prices to record levels. Surely, the deficit has an impact on these trends, but it is hardly the decisive factor it has been made out to be. The type of monetary policy conducted by the Federal Reserve has been shown to have a much more direct and powerful effect on the economy than the deficit.

I do not mean to suggest that continued deficit spending has no negative consequences. If nothing else, chronic deficits mean the country has to divert an ever increasing percentage of national wealth to cover interest payments on the national debt at the expense of more productive purposes. In a few years, at current trends, annual interest payments could equal the deficit in size, meaning that the government would have a balanced budget were it not for the debt service. It would indeed be ironic if the government eventually raised taxes to cover these interest costs as a result of today's decision to finance the deficit by borrowing rather than raising taxes.

It also is possible that the severe economic damage predicted to result from deficits ultimately will occur, but that is not the focus of the political debate I detect in Washington. I have come to believe that the deficit has become little more than a convenient excuse for pushing other goals. The real budget debate I sense is not over balancing the budget but over the size and scope of the government's role in society. The President obviously believes that government should play a smaller role except in national defense, and he has used the deficit as a weapon to achieve that end. Similarly, administration opponents bent on preserving social programs first created in the New Deal cite the deficit as their reason for raising taxes and cutting defense. I believe even the Federal Reserve uses the deficit as an excuse, in its case to keep interest rates at unpopularly high levels to combat inflation.

We in the news media have focused more attention on the symptom - the deficit - than the underlying dispute over national priorities. As a result, the general public seems to want both a balanced budget and a "free lunch." People will say deficits are bad if only because the government has a moral obligation to live within its means, but there is not an accompanying cry for tax increases and cuts in popular programs to achieve that balance, except if someone else's ox is to be gored.

The Gramm-Rudman-Hollings legislation, which seems to have been created out of the utter frustration of political stalemate, perpetuates this contradiction. It lays out a neat timetable for achieving a balanced budget but conveniently avoids making the tough choices required to get there. After all the balanced budget promises of the past five years and the unexpected economic events that derailed even the most

sincere projections, why should anyone believe in another five-year balanced budget plan that is not backed up with a single program cut or tax increase?

This is no time for more political procrastination. It is time we talked more directly and honestly about how big a role government should play in our lives and how we should pay for it rather than argue in the abstract about deficits. Until we confront the real alternatives, we cannot make honest choices.

REPORTAGE OF BUDGET ISSUES

by

Helen Dewar
The Washington Post

January 11, 1986

You can tell them by their squinty eyes, hunched shoulders and -- if they have any sense -- orthopedic shoes. They mutter strange incantations about "sequestering," "cross-walks" and "obligated balances." They travel in packs, drawn together by the need for solace from others of their breed and, sad to say, because others shun them out of fear that their affliction may be contagious.

But the life of a budget reporter on Capitol Hill is not all bad.

Editors who are always pestering reporters with exciting stories will go days -- months if they could get away with it -- without calling a budget reporter on the telephone. Nor do they mess much with a budget reporter's copy; they tend to like to rewrite things they understand. Also, frequently there is a turf problem for reporters with glamorous beats; someone else is always trying to snatch the story. Budget reporters have no problems holding onto their stories; they can't even bribe colleagues to take a piece of their action.

Readers may not rush out to newsstands to search for the latest development on budget "reconciliation," but the importance of budget coverage and analysis has grown dramatically in recent years in tandem with the country's mounting concern over federal budget deficits.

This, in turn, has put enormous strains on reporters and editors to cover the subject in a way that is understandable and interesting to the average reader without doing violence to the nuances of a very complicated situation.

It is an economic story but also a political one, touching on everything from defense policy to agricultural issues, from presidential leadership to power balances within Congress. For congressional correspondents, it has become the most important running story of the year -- a "soap opera without sex," it has been called.

Some of us, who may or may not squint, sag or wear orthopedic shoes, spend most of our time on the budget, largely because it has become a virtually all consuming issue in Congress. But almost every reporter in Washington -- and, I'm sure, in state capitals and city halls across the country -- has been dragged into the brave new world of budgeteering, willingly or not, prepared or not.

And, despite what is undoubtedly scant readership for lengthy analyses on the budget process, the daily drumbeat of coverage of the budget has focused attention on deficits and, I suspect, contributed to

the rising level of concern in the country about the problem as a whole. People may not work up much of a passion over whether Congress meets its deadline for a first budget resolution or how budget "reconciliation" works, but they want to know what the bottom line is and look to the news media for help in trying to find it.

This puts a particular burden on those who handle budget stories, editors as well as reporters, to make the subject interesting without distorting or "hyping" it. It's easy to grab a headline, for instance, with a story about cutting Social Security. It's a lot harder to explain the Gramm-Rudman sequestration process, although in the end it may be vastly more important.

There is also a question that is troubling to many reporters in many areas, namely the influence of news coverage on events and the public's perception of those events.

For many years, I suspect the paucity of stories about deficits contributed to a political climate that fostered their growth. But now there is such a deluge of coverage -- more so in newspapers than on television and radio -- that media coverage is probably influencing opinion in the other direction.

Coverage is particularly exhaustive in metropolitan area newspapers such as the New York Times, Los Angeles Times and Washington Post. But it seems to be creeping up in smaller papers as well, and gets increasingly frequent mention, although less extensive coverage, in the electronic media.

Of course, a full discussion of the issue is good, and there is enough evidence to suggest that deficits are dangerous to our economic health to merit extensive coverage and analysis. But I can't help wondering whether the crescendo of coverage hasn't created a climate that has led -- for good or ill -- to quick fixes such as the recently enacted Gramm-Rudman-Hollings legislation to require a balanced budget within five years.

I think of this frequently as I read eloquent newspaper denunciations of the legislation.

Handling of budget news has changed dramatically in the six years that I have been covering Congress, and I'm sure the change would seem even more pronounced if one were to go back to the days before passage of the Congressional Budget Act eleven years ago.

Through even the campaign year of 1980 that led to the Reagan presidency, budget coverage was limited to a few stories of a fairly routine nature every few weeks, generally when budget deadlines fell. But, with Reagan's election and his first budget, the story immediately became the dominant one from Capital Hill.

Most of the major papers detailed one reporter to be primarily responsible for congressional budget activities, although not necessarily to the exclusion of everything else. I had dabbled with the budget the

year before and reported on the Senate, which was expected to lead the charge for Reagan's budget, so I was the logical choice to do most of the budget work on the Hill. Our White House reporter covered the budget from that end of Pennsylvania Avenue, and several financial page reporters handled the economic aspects of the budget, as well as details of the tax legislation. In addition, there were occasional stories on the local impact of major budget decisions.

The pattern of coverage of the budget in Congress continued in later years, ebbing and flowing with the intensity of the budget battles. But it remained the dominant congressional story for the entire Reagan first term, reaching a climax last year in the first year of his second term.

On Capitol Hill alone, it is now a full-time job for one person, with others swinging in at peak times to help. There is what amounts to a full court press on release of the President's budget, and the events, disputes and "leaks" leading up to it. Most newspapers and networks attend nearly all the budget hearings and mark-up sessions for the congressional budget, with additional time spent on the maneuvering that occurs outside the official public meetings, which is often more important.

To some extent -- although far too little, I think -- there is also an effort to follow through on what happens in Washington with reports on how a particular budget controversy or budget decision is affecting the people on the receiving end. In other words, how are hospitals coping with the Medicare freeze? What is Mudville going to do without revenue sharing? When they are more than the easy, superficial, hand wringing kinds of stories, these can tell more about what Washington is doing to the country than a hundred stories written out of the House or Senate press galleries.

Reporters who cover the budget started, at least, as normal people. Some have an economics background, either from college education or from previous professional experience. But more, at least congressional budget reporters, are generalists, political reporters in the broad sense of the word, who got their economics training on the job. Nearly all have had a broad range of experience covering governmental agencies, political campaigns and, in many cases, municipal and/or state governments.

This is not by accident but rather reflects a conscious decision on the part of their editors that the budget process is basically a political, or general governmental, story.

In part because of my somewhat casual encounter with Economics 1 and 2 in college, I tend to share that view, although there are more times than I care to admit that I wish I had listened a little more attentively to those painful 8 a.m. lectures. The process is basically political, as is everything in Congress, and the more important an issue becomes, the more intensely political it becomes as well.

For instance, exempting Social Security from spending cuts -- or failing to raise taxes -- may be poor economics, but it has been judged

for now at least to be good politics. Politics and economics are obviously linked to the extent that people vote their pocketbooks. But the budget process, as it has evolved over the past decade, is largely a congressional mechanism for bringing some order out of conflicting pressures that Congress feels on fiscal issues. The policy decisions that are made within this framework remain basically political.

Like everything else in official Washington, the budget is the subject of manipulation aimed at the news media, sometimes successfully, sometimes not. Often the attempts at manipulation are disturbing; more often they are clumsy, silly and counterproductive.

During the early years of Reagan's first term, the administration and its congressional allies capitalized on the media's thirst for the breathless "we have learned" kinds of stories by leaking its budget in advance, summarized, of course, with a slant favorable to the administration. Then administration officials yowled with righteous indignation that the press was being greedy and telling secrets before their time.

I remember -- cannot ever forget, in fact -- trying to make sense out of the entire federal budget in about 45 minutes of frantic reading and deadline writing late one Friday afternoon, listening as I worked to frenzied page flipping from a similarly occupied New York Times reporter at his desk just a few feet away. We had separately gotten the budget summary from a Republican aide who was dispensing them as fast as his copier machine could churn them out.

As reporters, we were frustrated because we knew we were being used. We could not ignore the documents; they were legitimate, and unlike the budget document itself, had not been embargoed for publication at a later time. We could -- and did -- cast the stories to reflect the fact that the administration had leaked them for a purpose and with a spin that accentuated the positive from its point of view. But it was still a skewed story, controlled by the source because the objective details were still under wraps.

Only when the situation reached total chaos a couple of years later, with newspapers breaking the embargoes in response to gusher sized leaks, did the situation come under control. Now we do modest sized, matter of fact stories when the budget summary is leaked and reserve our resources for details of the real document -- which is probably what should have been done in the first place.

A greater problem than clumsy efforts at manipulation of budget stories is the difficulty of getting at the reality behind the numbers in both presidential and congressional budgets.

The problem is not just things like the so-called "magic asterisk" that both the administration and Congress have used to indicate savings when they do not know or do not dare say precisely what they have in mind. In a more serious vein, there is such complexity to the whole array of federal programs that cuts affect each program differently; important sounding cuts can be cosmetic only or conversely innocuous

sounding trims can spell disaster; cuts that can save money in the short run can cost money in the long run; sometimes it is necessary to spend money to save it.

But the process itself is an extraordinarily open one, and the professional budget staffs on the Hill tend to be fair, informed and candid. For a variety of reasons, including the touchiness of issues such as Social Security and taxes, there seemed to be a tendency this year, however, to close formal meetings to the press and public. It started with drafting sessions of the House Budget Committee and extended to final negotiations on the Gramm-Rudman-Hollings bill. Critical policy decision often have been made in private, of course, especially around the conference table in the Senate majority leader's office or in the House Speaker's office hideaway. But deliberations of the committees themselves usually have been open.

Mitigating the effect of the tendency toward closed doors, however, is the congenital blabbiness of politicians, reinforced in this Congress by the partisan split between the Democratic-controlled House and Republican-controlled Senate. No secret is secret for long.

With passage of the Gramm-Rudman-Hollings bill, budget coverage in Congress will only intensify, both from the economic and political perspectives. The deferral and likely demise of budget targets, and the tax reform bill that was sent to the Senate by the House open up the possibility of a tax increase to offset the deep spending cuts that will be required for fiscal 1987. Depending on the economy's performance at the time, there may be serious questions about the effect of steep spending cuts and/or tax increases. The 1986 congressional elections will only further complicate the picture.

For budget reporters, there is one consolation: a case can probably be made for combat pay.

ECONOMICS REPORTING -- ONWARD AND UPWARD

by

Paul Duke

January 11, 1986

Economics reporting is the newest status symbol in the American press. While it may not qualify as an exalted art form just yet, it certainly is out of the dusty corner of the newsroom and into journalism's mainstream. As a consequence, the public today is being better informed about economic issues than ever before.

Perhaps nothing illustrates this more than the battles of the budget that raged throughout 1985. No story received greater attention on Capitol Hill than the attempts to deal with the deficit, culminating in passage of the Gramm-Rudman bill last month. In fact, when combined with coverage of the tax reform fight, economic-related stories dominated the news flow from Capitol Hill as never before.

The quality of the coverage was exceptional. Despite criticism from Rep. David Obey (D-Wisc) and several other members that the press treats too many stories from a political standpoint -- who wins, who loses -- the budget story was covered primarily as a substantive and difficult problem for the nation. The interplay of political forces obviously was a part of the story and could hardly be ignored, especially since both Republicans and Democrats spent a good bit of their time maneuvering in fail-safe ways designed to avoid blame for the prolonged deficit deadlock. All of this was detailed in the press -- but much more as well.

In one edition of the Washington Post, there were seven stories on the Gramm-Rudman fight and two editorial page opinion articles. All facets of the legislation were explored -- the measure's key provisions, its leading promoters, its workability, its constitutionality, its effect on the government and the country at large. Gramm and Rudman may not necessarily be household names, but newspaper readers, magazine subscribers and television viewers who follow public issues could hardly complain about an inadequate supply of information.

(Indeed, the protracted fight over Gramm-Rudman seemed at times to take on the atmosphere of a world series on economic policy. The stories not only dealt with the principals but also portrayed the major staff assistants who helped craft the legislation, colorful descriptions of the Senate-House conference meeting rooms and the theatrics of the participants. There were references to House Budget Chairman William Gray sporting a button proclaiming "Take the Medicine Now." Headline writers let their creative talents flare. Best examples: "Risky Abracadabra" in The New York Times, "By Any Name, Gramm-Rudman is a Sham" in the Los Angeles Times and "Know-Nothing Legislation" in The Washington Post. Along the way there was even an occasional profundity, such as the comment of Franco Modigliani, the 1985 Nobel prize winner in economics, that "we cannot really avoid raising taxes. If we refuse to pay them now, they will be paid by our children.")

All of this represents a big leap forward from 25 years ago. At that time economic issues still were being treated largely as an arcane science primarily of interest to experts or a limited number of well-informed people. "We used to write for our peers or the people at Brookings," says Robert Farrell, the chief of BusinessWeek's Washington Bureau. "Now everybody asks -- how will this affect the average American?"

The attitudinal change has been enormous. It used to be that most major newspapers and magazines were content to leave the detailed, complex reports of business and economic developments to The Wall Street Journal, BusinessWeek and a few other more specialized publications. Television was a wasteland, frequently not even mentioning important trends other than bare bones figures. Editors routinely assigned economic stories to the back pages. Rookie reporters were routinely assigned to the business beat, and if they didn't show any particular talent or skill, languished there.

The change is most evident at the big city dailies. The New York Times, the Los Angeles Times, The Washington Post, The Chicago Tribune ago many others have greatly expanded their coverage, replete with special sections and many more in-depth articles and analyses. In the early 1960's, for example, The Washington Post had a full-time business editor and one full-time business and economics writer. Today there is a staff of 35, with specialist writers on banking, technology and consumer affairs. The Post devotes seven times more space to its coverage as it did 20 years ago.

Television is much better, too. The commercial networks now have reporters assigned to the economics field. Public television has gone even farther and pioneered in specialized programming, i.e., Wall Street Week, Money World and The Nightly Business Report -- all half-hour programs. Cable systems likewise are pushing ahead with specific coverage of economic and financial activities.

Moreover, today's journalism goes far beyond the mundane statistical data that once comprised the backbone of most economics reporting. There is a recognition that some of the biggest stories are business and economics-related -- the rise of technology, the service industries and the health care problems of an aging population. Similarly, the budget has been accorded major treatment -- how could it not be, the deficit having skyrocketed so dramatically during the Reagan presidency! -- because it is uppermost in people's minds and no longer is viewed as a microeconomic story but as one with a potentially serious impact on millions of lives.

This explosion in economic news has brought a new dignity and a new respect to economics reporting. As Columnist Hobart Rowen of The Washington Post aptly put it: "The economics writer used to be a step above the church page editor and often he was the same person."

All the same, progress has not produced a panacea. Deficiencies and shortcomings persist. Laudable though the improvement may be, it is not universal.

For one thing, many medium-sized and smaller newspapers still give scant attention to economic issues and frequently ignore significant developments. Television still gives only superficial coverage to many Capitol Hill actions, often little more than headline mention. A more extensive use of graphics, in the style of the magazines, clearly would help in illuminating complicated issues for TV viewers.

For all the improvement in the quality of economic journalism, the standards for good reporting are not always clearly defined. Newspapers have much less trouble in finding personnel interested in the field than in finding truly good writers, with an ability to explain and elucidate in crisp, plain language.

The wire services continue to give stepchild treatment to much that goes on in the economic arena and their reporting often is characterized more by superficiality than sophistication. The Associated Press and United Press International still cannot escape the tendency to succumb to White House propaganda on occasion. A recent UPI story gave a glowing account of how the President had "celebrated" two major victories in Congress -- final passage of Gramm-Rudman and House endorsement of tax reform. Unfortunately, the story omitted two important points -- (1) that White House aides fought furiously against any severe cuts in defense spending as mandated by Gramm-Rudman and (2) that Mr. Reagan had initially been humiliated in the tax reform fight by getting only 14 Republican votes; only a major White House rescue operation and a personal visit to Capitol Hill by Mr. Reagan turned things around.

There are weaknesses in some of the newspaper coverage as well. Few papers devote much attention to international financial problems, although the growing world interdependence obviously makes this a more important area. At the opposite extreme, the slightest blips and gyrations of the money supply are analyzed and reanalyzed at great length.

Nonetheless, most of the news these days about economics reporting is good news. The caliber of the coverage is vastly better and the quality of the reporting is at an all time high. Editors no longer look down their noses at this phase of the journalism business and there is a general acknowledgement that the public has a greater right to know about the issues that affect the quality of American living. This recognition is one of the main reasons that the struggle over the budget has become a very big story.

TURNING THE TABLES: REPORTAGE OF BUDGET ISSUES

Discussion

Panelists:

Representative Buddy MacKay, United States House of Representatives
 Representative Delbert Latta, United States House of Representatives
 Representative David Obey, United States House of Representatives

PAUL DUKE. Thanks very much, Carol. Let me just say at the outset that I think it's high time that this conference had a woman moderator. And I'm going to leave it right there. You've done a great job.

We've had a lot of bashing of the President at this conference, criticism of Mr. Reagan for not showing leadership in dealing with the budget dilemma. I suspect that some of you this morning are now just waiting to bash the President, as well. If indeed that is the case, so be it. But I would just like to say that, differing with Owen to a certain degree, I do not come here this morning as a nattering nabob of negativism, but more as a nattering nabob of positivism. There's always been tension between the press and the politicians in this country. And it goes back a long way. Thomas Jefferson felt the press could not be trusted in America and he once suggested that what was needed was a separate newspaper page labeled "Lies" at the top. Alexander Hamilton called the press a "wild animal in our midst." Back in the latter half of the 19th Century, there was a New York publisher named Horace Greeley who ran for President. He encountered so much venom from other competing newspapers that he said one day that he did not know whether he was running for the penitentiary or the presidency. Some of us remember when John Kennedy was in the White House, he felt the press did such a poor job of covering his Administration that at one juncture, he order all copies of the New York Herald Tribune stricken from the White House shelves. The newspaper was just not to be delivered to the White House. I think Ronald Reagan, to his credit, is one of the few presidents who has retained his sanity about the American press.

I saw a poll the other day suggesting that respect for the press and for television coverage in this country has now gone up somewhat unbelievably, but my own encounters with the public and with the politicians who criticize us, leads me to believe that we're still down there somewhere among the streetsweepers. It's no secret that a great many people in this country have strong feelings about the press and how it goes about its job, and that's reflected in the mail which I get from my own program. We get a great deal of mail for "Washington Week," and a lot of it comes from people who have no appreciation for the art of flattery and have no hesitancy about letting you know they have no appreciation for the art of flattery. Just to cite a couple of examples, we got a letter the other day from a man in Goldsboro, North Carolina, who complained about one of our discussions which involved some criticism of President Reagan. He said he had written the President directly, "This program could be hazardous to my health, Mr. President, causing my blood pressure to go up; but even so, at the age of 81, I've decided to live dangerously." My favorite letter came from a woman in Milwaukee who

objected to something that was said on the program back in 1981 about Jimmy Carter. She wrote and said, "You are wrong in saying Jimmy Carter is dumb. He isn't. He's stupid. You're dumb." So you can plainly see that bashing the press is an old American tradition, just as bashing the politicians is in this country.

I don't mean to be a totally good news messenger this morning because we are certainly far from perfect. There still is too much superficiality in the coverage. And I agree with some of the things which Owen was suggesting just a moment ago about relating the stories more to the public. Television, having come a long way, still has a long way to go. It still has got to find ways to simplify and diagram and to use the new razzle dazzle technical techniques to make the statistics of economics and the figures of the budget stories meaningful and easy to understand for the average viewer. But on the whole, I would have to say, Carol, that I think it's a far different ball game as far as coverage of the press is concerned in economic matters, and of Capitol Hill economics issues today than it was ten or twenty years ago.

REP. BUDDY MACKAY: I was not here to see budget reporting before. I am willing to accept that it is better today; but if that is true, then we have just identified one of the reasons the country ended up in this situation. My constituents do not understand the problem of the budget deficit in the way that Mr. Ullmann has described it. I think his thesis is correct: the real debate is not about balancing the budget; the real debate is about the size and scope of government in America today. However, my constituents do not understand it that way.

I think I am typical of a fair number of Members of Congress in that I am really trying to see the budget debate as a proxy for that real debate in our society. I have trouble dealing with it in part because I spend a great deal of time saying to my constituents, "No, there is really a great deal more to it than these little day to day vignettes that you see."

I think probably my argument is not with reporters; I think it is more with the editors and producers. The budget simply does not fit within the format of a daily confrontation between a good guy and a bad guy, a little plot with some suspense in it, and an ending -- all of which occurs in a finite period.

One problem with the deficit is Congress' attention span. If it is not something we can deal with in two years, then we really have trouble. I think in some ways the press also has an attention span problem. This issue is too big to fit within our daily attention span.

I do not know how to deal with it, but I think if someone really were to commit himself to Mr. Ullmann's thesis, he or she would find that it is an absolutely fascinating story. I even think it is a story that will sell. It would help us to deal with one of America's real underlying problems by remedying the lack of context. We cannot get up a head of steam for some very logical proposals in part because the press has yet to explain them to our constituents, and our constituents have yet to hold us accountable. I am sorry, that is a long answer and two or

three editorials.

REP. DEL LATTA: I am the only Republican in Congress who is sentenced to permanent service on the Budget Committee, and I thank John Rhodes for that.

Let me say I do think that the media has been paying more attention to budget and deficit problems than when I first joined the committee or when I first came to Congress twenty-seven years ago. The coverage is much more extensive now. Whether or not that means it is better, you will have to judge for yourself.

I have been saying for some time that I think we are at a crisis. I think we need some help from the media -- help I do not think we have been getting. The press may report about a deficit or the budget, but I do not think they really scratch the surface. I feel that every time we attempt to make some reduction in programs, the press runs to the special interest groups and reports immediately that we are going to cut their favorite programs. Right away we receive telegrams and letters and telephone calls saying, "You can't do that to us!" So you might as well mark off that cut.

In marking up the budget, I would like some time to have some cooperation from the press: just play it down a little bit until we get the package all put together, and then maybe we can do something for the best interest of the country. That just has not occurred.

Let me give you a good example. When we were trying to come up with a budget for 1986, we had a conference committee that could not come to any kind of an agreement, so Senator Domenici and Senator Chiles and Chairman Gray, and I met as a subcommittee of a subcommittee to try to come up with a budget. Everything was supposed to be quiet; we were not supposed to be reporting anything. Well, unfortunately, the committee chairman had to go back to his chairmen to find out whether they would go along with his various reductions in their jurisdictions. Naturally, they would not. It seemed as though this information was getting out all the time to the special interest groups across the country whenever we would attempt to make a reduction. I really think that at some point we are all going to have to say, "This is our problem, and we must get it solved." So all of us -- press included -- ought to work together in the best interests of the country. Sometimes I think the best effort would be not reporting anything until we get something accomplished. And that would be my first criticism.

CAROL COX: Are you arguing, Delbert, that they ought to help you explain the cuts to the country more constructively, or that they ought not to report them at all?

REP. DEL LATTA: Well, let us get it into some form before they destroy it.

OWEN ULLMANN: Why doesn't Congress then do the right thing for the country by resisting the special interests and voting for the reductions anyhow?

REP. DEL LATTA: Let me say that I have been around there long enough to know that there is not too much backbone on Capitol Hill. They cave in quite readily. You ought to give us a little help in stiffening that backbone by not reporting everything you might pick up. I am not saying that you should not ever report, but you ought to use good judgment and sometimes decide, "Maybe we ought to help a little bit and not report this one until they do something about it."

OWEN ULLMANN: I get a lot of my best information from departments and agencies -- people who work for the different departments of the government. It is not the outside groups, but the inside groups -- that are fighting your cuts.

REP. DEL LATTA: Oh sure. They scream bloody murder at you as soon as you threaten to take a dime away from them; they want to spend it.

REP. DAVID OBEY: I am not just pleased to be here. I would have killed for the pleasure of participating in this panel! But let me put my comments in perspective. It is true that I am an outspoken critic of the press, especially television. It is also true, however, that I am an outspoken critic of the Congress. The President's recent statement that the Congress' budget process is not structured to deal with the needs of the country is correct. I think Kevin Phillips' paper makes a pretty good case that the executive branch is also badly structured to deal with a lot of economic issues.

Yesterday, I had a shock. I thought I was going to be in a mild mood, and then I missed two airplanes, and while I was waiting for third airplane in the Minneapolis airport, I watched NBC's coverage of the Gramm-Rudman-Hollings court case. I was surprised because I thought they summarized in a very short time exactly how Gramm-Rudman-Hollings was supposed to work. In fact, I thought it was probably the best job I had seen of spelling out specifically what the mechanism was supposed to be.

Then just when I was in the mood to congratulate them for doing a good job, Carl Stern ended the piece by saying that Gramm-Rudman-Hollings is a monster created by Congress which was reluctantly accepted by the President! Those of us who recall that for a month the President refused to sign a debt ceiling extension until we gave him Gramm-Rudman-Hollings would be a little surprised by the assertion of that NBC piece. And that put me in the proper frame of mind for this morning's discussion.

I have tremendous respect for the three reporters at this table. Paul Duke may do the best job on television, in his weekly Friday evening show, of explaining what is happening in Congress and on Capitol Hill to the country -- and also, for that matter, to the Congress. Nevertheless, I flatly disagree with most of the assertions made in Paul's written statement.

Paul suggested that the quality of coverage on budget and economic issues was exceptional. I would dissent very strongly. It is probably true that the quality of congressional coverage is much higher than it was in the fifties, just as I think it is true that the intellectual quality of the Members of Congress has risen in the seventeen years I

have been a member. Nonetheless, if you look at the job done by both of those institutions and measure it against today's needs, neither institution has any right to brag.

Let me challenge one specific example in your paper, Paul, and see if we can get a discussion going. You said the Washington Post gave seven times more space to its economic coverage than it did 20 years ago. You also listed the New York Times, Los Angeles Times, and Chicago Tribune among those having much better coverage. You said, and I quote, "The protracted fight over Gramm-Rudman seemed...to take on the atmosphere of a world series on economic policy. The stories not only dealt with the principals, but also portrayed the major staff assistants who helped craft the legislation, colorful descriptions of the Senate/House conference meeting rooms and the theatrics of the participants. There were references to House Budget Committee Chairman Bill Gray sporting a button proclaiming, 'Take the medicine now.'"

I suggest that that is not economic reporting. I would grant you that on Gramm-Rudman-Hollings, the major newspapers did the best job of political reporting I have seen on a major issue in quite some time. It was superb. They also did a pretty good job of describing the programmatic results that could occur and the tensions between various conflicting constituencies: defense versus agriculture versus social spending, etc.

But I did a study of the articles written by the Washington Post, the Wall Street Journal, and the New York Times for the period from October 3rd through the passage of Gramm-Rudman-Hollings. We coded the articles. If it was primarily on defense and the impact on the defense budget, we coded it "defense." If it was a story about how the bill or the arguments about it were changing, we coded it "evolving bill." If it even mentioned in one sentence macroeconomic questions being raised by the bill, we coded it "mentions economics." If there were more than four paragraphs on macroeconomic questions, we coded it "extensive economics."

Of the some 70 major articles during the period, 43 gave extensive coverage to the politics of Gramm-Rudman-Hollings. Three provided extensive coverage of the economics as opposed to programmatic issues involved in Gramm-Rudman-Hollings, and one of those three appeared after the bill had been passed.

Then I went back and compared this to the coverage of the Gramm-Latta bill in 1981. I note that Paul indicated he felt that the reportage on Gramm-Rudman-Hollings was better than the reportage on Gramm-Latta. In the ten days before Gramm-Latta passed in 1981, there were ten major stories in those three papers. Seven or eight of those stories mentioned in a significant way the importance of the debate over economic assumptions during the Gramm-Latta debate. I would suggest that the coverage of Gramm-Latta, in terms of straight economics reporting, was superior to the coverage of Gramm-Rudman-Hollings.

If you compare the network coverage of Gramm-Rudman-Hollings and Gramm-Latta with the print coverage, the print coverage comes out looking very, very good. Until August 1981, after Gramm-Latta had passed, I

could find only one newsclip by the networks on Gramm-Latta which made reference to the issue of economic assumptions. It was only after the Congress went out of town and the networks didn't have the ntional zoo to cover that they had time to go back and look at whether or not that package met the economic expectations upon which it was based. That is when the network coverage of these issues began. If you take a look at the network coverage of Gramm-Rudman-Hollings, there was virtually no discussion of the economic implications as opposed to the programatic implications.

You could call it good budget reporting, in the sense that this program is going to get less, rather than more; but I do not think you could call it adequate economics reporting. To be that, it would have to lay out the arguments about what this proposal is going to do in different economic circumstances.

When Professor Modigliani appeared before our committee, the two stories about Gramm-Rudman-Hollings the next day which mentioned his testimony did so at the tail end of the story. One story merely referred to his comment that Gramm-Rudman-Hollings was mickey mouse, without explaining why he said it was mickey mouse. The Times did include several good paragraphs describing why Modigliani thought Gramm-Rudman-Hollings was dangerously procyclical as opposed to counter-cyclical.

When Walter Heller appeared before our committee, there were two references to his testimony: one listed his name as a witness; the other said Heller wanted to see the proposal slowed down politically. There was no reference at all to Heller's major economic arguments.

I looked very hard to find anything more than a paragraph or two on the Budget Committee hearings on the economic impact of Gramm-Rudman-Hollings; I found little beyond one story in the Post and one in the Times. I think that the press has a very big job to do in addressing economics as opposed to political or budget spending issues.

There is one other problem. I think the press has even less of an institutional memory than the Congress has on economic issues. Take a look at the number of years that people have been on the same beat in the press. I do not know what the average is for Congress. Two years ago I think that average length of time a White House reporter spent on that beat was less than four years. The amazing thing to me is that, with the exception of a few people, you have reporters on Capitol Hill rotating almost like popcorn.

I had an interesting experience when I was being interviewed by one reporter on Gramm-Rudman-Hollings. He wrote some of the better articles on Gramm-Rudman-Hollings, but he had not been around when we had Gramm-Latta, so he did not know what the connections, trails, or common themes were. I think that is a problem because you need to have been around Congress for a fair amount of time before you can remember what the earlier arguments were and put new ones into context.

Finally, in terms of explaining to the public what is happening,

newspapers miss the bet if they justify themselves on the basis of what is on the business page. You need more economics analysis on the front page, rather than on the business page, unless you want only corporate CEO's in the country to understand what you are talking about in those articles.

CAROL COX: Alice Rivlin once told me a story about the lack of institutional memory. When she was director of the Congressional Budget Office, during the consideration of Gramm-Latta, CBS sent a reporter to interview her to provide the basis for Dan Rather's evening news report. She said the reporter they sent was a very nice young man, but he did not know what the CBO was, what her job was, what the congressional Budget Committees did, or even who Gramm and Latta were. She said it took her three hours to walk through very basic background information in order to provide any information at all! If that is a typical case, then we should not be surprised that what Dan Rather says on the evening news is often very disappointing to many of us.

PAUL DUKE: What strikes me this morning so far, after listening to David [Obey] on my right and the two Congressmen on my left, is that each of you has a different agenda for the press. Each of you has a specific agenda you think the press corps should be following. For example, Congressman MacKay suggested that we should have more extensive coverage of things of interest to him. I dare say that 534 other Members of Congress would say the very same thing. Congressman Latta, on the other hand, suggests that a part of his agenda is for us not to report some of the things which are of interest to him. So right off the bat there is a problem in trying to satisfy the individual Members of Congress who have their own particular ideas and beliefs about what the reporters on Capitol Hill or the reporters who come to Capitol Hill to cover specific economic issues should be doing.

I certainly agree that some of the initial coverage of Gramm-Rudman-Hollings was not up to par, was confusing and not as complete as it should have been. I think there is an explanation for that: There has been a great deal of confusion on Capitol Hill about Gramm-Rudman-Hollings and what it means. The press has been just as confused as the politicians. I do not really think that Gramm-Rudman-Hollings, because of all the complications and all the constitutional issues which are still outstanding, lends itself to the kind of refined microanalysis of which you happen to be talking.

David, you mentioned that you thought the reporters gave short shrift to the coverage of the testimony of Walter Heller and Dr. Modigliani. Recognize that congressional hearings have 10-25 witnesses, and there is a limited amount of time for television, limited space for the reporters, and judgments have to be made every day. Sometimes the judgments are good; sometimes the judgments are bad. I dare say you wanted more extensive coverage of Walter Heller, who happens to be a liberal economist from Minnesota. Somebody else might prefer more coverage for a conservative economist who testified. There are very practical problems which the press encounters in its coverage of stories on Capitol Hill, in trying to define what the news is, trying to give comprehensive and fair coverage to the participants who do testify, and

trying to give some meaning to the hearings and other actions which occur on Capitol Hill.

Reporters certainly are not perfect. Reporting is not a refined science, in the sense that the choices you make may not be the choices with which everybody would agree, but I think most of the reporters these days do have some expert knowledge of the story, and I think they are trying to make the right choices even if they do not always succeed.

REP. DAVE OBEY: I do not have an agenda for the press. I was simply taking your own assertion, Paul, that the quality of coverage on budget and economic issues was exceptional. The point I am trying to make is that while I think the budget coverage, defined in that sense, is very good on the Hill, I do not believe that the economics aspects of the issue have been covered well at all. I do not care whether it is coverage of Heller; coverage of Herb Stein or Charlie Schultze or any of the other people who testified. Coverage of any of their testimony would have explained the facts about the macroeconomic issues at stake here.

As an inside player what amazes me -- I noticed Helen refers to this in her paper, and I know a lot of sensitive news people have been concerned about it -- is the degree to which the kind of coverage you get changes what you do on the inside. I attended some 74 meetings on Gramm-Rudman-Hollings, and I kept a log. The frustrating thing to me was that in the first two weeks the Democrats in the House tried to make a major point about the procyclical nature of Gramm-Rudman-Hollings, i.e., that it wiped out the automatic stabilizers.

After two weeks we made a conscious decision never to raise this issue again because we were not getting anywhere in the press, most especially with television. There was a flurry of articles in the Post, the Times, and one in the Wall Street Journal mentioning some of the macroeconomic considerations; but with the exception of that 5- or 6-day period, it just died. So we gave up on something we thought was a major point, because we could not get any coverage at all on it -- because the press was much more interested in whether Weinberger was going to be able to protect defense. The latter is a traditional budget issue, but it is not an economic issue.

HELEN DEWAR: Perhaps it is a mistake to try to divide a political story from an economic story because, particularly in the case of arguments among elected representatives, one tends to drive the other. For instance, political philosophy or political needs, or constituent demands, frequently tend to shape the economic argument someone makes. Frequently, you can anticipate what a person is going to argue even in what appears to be a purely economic debate. You know the argument will be from his/her political background. Particularly when you are dealing with something that is structural institution-political, as is Gramm-Rudman-Hollings, the argument almost has to be mainly political.

In addition the economic issue often is framed in such a way that it is very, very difficult to translate into plain English -- even if you have five or six inches in a story. The phraseology that you use, for instance, is almost impossible to translate into a story. I understood

your macroeconomic arguments, and I agree what you were talking about was important, but often it simply is not explained in a way that makes it easy to convey, particularly in a short article.

REP. DAVE OBEY: Helen, I recognize all that. What I am saying is that the mix was wrong. Out of 70 articles, only twelve even mentioned the issue, whereas some 43 gave substantial mention to the politics, 11 gave heavy emphasis on the question of budget priorities, and 8 focused on the defense issue alone. Thirteen of those stories focused primarily on the changing nature of the bill as it went through Congress. It seems to me legitimate to ask whether the economic aspects are being ignored.

REP. DEL LATTA: Paul, let me first say that I did not mean that you should not report what we do. The question is when you report it.

PAUL DUKE: In other words, put it in the deep freeze sometimes.

REP. DEL LATTA: Sometimes, for a day or so, until we get it worked out. Let me make another comment about duties of the press. The press should do more than just report the news on this budget issue; there ought to be more educating of the public. I really do not think that is happening. If we are going to do what we have to do for the benefit of the country, there will be a lot of screaming and yelling and wringing of hands across this country by every group that has had its hands out and has been getting them filled by future generations. We are going to have to educate the people to understand that when we talk about a particular program, "This is only your part; there are a lot of other parts we are going to have to put together. We are not singling you out for any particular adverse treatment." I think the press could help the Congress and help the country immensely by explaining this rather than just saying "We are not going to repair the sidewalks in Bolling Green." (That is my home town. They just used Federal funds to repair the sidewalks. It was absurd; we are not going to do that anymore.) Instead of just pointing out one particular thing, the press could help the country and the Congress in getting to this problem by this educational process.

REP. JIM SLATTERY: To be fair to the press, it seems to me that those of us who are Members of Congress ought to recognize what artful ploys we -- and members of the executive branch -- use to obfuscate and confuse this issue. I will be very specific. The President, for example, and Members of Congress as well, will use certain sets of numbers to show how big the cuts have been when that is to their advantage. We will use a different set of assumptions, a different "baseline," if you will, to argue how small the increases have been when that fits our argument. The President has gotten by with this for five years now on defense. Everything else is discussed in nominal dollars; defense is talked about in real dollars. This year, it will be the same story. The President will talk about a 3 percent increase in defense when he is really talking about what anyone out in the street would call a 6 percent increase in defense. A lot of this is done intentionally to confuse the public. I think we really need to break clean on that point.

I remember two years ago approaching the then-Chairman of the Budget Committee, Jim Jones, on the floor of the House and asking him really

what the deficit impact was of a certain amendment to the budget resolution. I remember that the answer I got was so confusing I ended up wondering: "What did he tell me?"

Basically he was pointing out that the Republicans at that time were using one set of economic assumptions, and the White House was using another set of economic assumptions, and the majority in the House was using yet another set of economic assumptions. And of course the answer to my question depended on which set of economic assumptions you used. Try to communicate that to the American public in 30 seconds or even 1 minute on the 6 o'clock news. It is virtually impossible.

Some things we did this year were a real step in the right direction: the Budget Committee agreed that we would use the OMB economic assumptions. Faulty though they may be, but at least we were going to use one set, so we would not be battling continually over what the economic assumptions were every time we raised any issue with respect to the budget resolution. I think we are making progress by agreeing upon baselines and economic assumptions.

JONATHAN FUERBRINGER: The first thing I would like to say is to Mr. Latta. It is absurd to ask that the press not report something for a couple of days so you can get something together. That kind of judgment, for us to hold off and not write about something we know, would be the first step of censorship. We just do not operate that way. You would not really want us to operate that way. It would be to your disadvantage if, in the long run, what you wanted out did not get out. I feel very strongly about that.

I want to talk a little bit about what Representative Obey was saying about Gramm-Rudman-Hollings, economics reporting and so forth. I think it is fair to say that at the beginning of the Gramm-Rudman-Hollings debate, the press was slow in getting on the bandwagon. The general impression back in September was that this was something to be added in the Senate so the debt limit increase could pass. Then it would die and we would never see it again. Soon after that, we -- and I include myself -- realized we were dead wrong. Suddenly we realized that this thing was going to get through the Congress, and that is when we began to write more about it. On a slightly defensive note, there are many things Congress does that do not get in the paper. I am not going to use that as an excuse because it is not a good one, but it is worth seeing it from the point of view of the reporter. People who cover the budget, I think unlike a lot of other reporters, do it mostly on their own. It is not like covering politics which editors love dearly and love to cover all the time. That means we decide to do many things on our own, and a lot of things we think important do not get into the paper. The timing of the deficit cuts, more when the economy is growing well and less or not at all when the economy is weak or in recession, was for you one of the most important issues in Gramm-Rudman-Hollings. You cannot blame us for the fact that the Democrats quit making the argument and it eventually died. If you want coverage on something like that, first of all you talk to us, but second of all you must push it more and more all the way down to the end; you know eventually you could have gotten more and more coverage on it. You cannot blame the press for the fact that

you just stopped pushing it.

REP. DAVE OBEY: I did not say that we dropped the proposal because the press was not covering it. I said we stopped trying to make that argument because we were not penetrating. When you are trying to get 218 votes in the House, what appears in the press every day is your best way of communicating with other Members. We dropped the proposal for other reasons as well, including the fact that the Senate and some others thought it was nuts. That is not my point. My point is that we stopped raising the issue, and so at least from the standpoint of making a record for future reference, the issue was lost. We dropped the proposal because we were licked on it. But it ties back to Helen's point: what you report and how you report it effects politicians' perceptions of the issues. It effects the debate.

HOWARD FINEMAN: Carol, since I cover politics for Newsweek and also occasionally appear on Washington Week, I want to say that both Dave Obey and Paul Duke are right. I think we do need more and better coverage of macroeconomic issues, but to look for it in the Gramm-Rudman-Hollings story is to look in the wrong place. I think the ratio of what you call political stories and economic stories was about correct on what was essentially a political story. As a political reporter who did cover budget for a couple of years, I see Gramm-Rudman-Hollings as essentially a political response to the political deadlock on the nature and role of government that we were discussing most of yesterday. Still I agree we do need more and better coverage, not just of economic issues, but of budget stories. I have watched budget stories grow now since 1982; a budget story is pretty much synonymous with the entire game of American domestic politics -- deciding who wins, who loses, and who pays. Now we have a generational problem in American journalism. I think when many of the editors with long experience hear the word budget, their eyes close automatically. It is the ultimate "meگو" story. Mego means my eyes glaze over. It is a story of undeniable importance and of insufferable dullness. The other problem we confront is that Congress has a tendency to turn even the most stirring flesh and blood story from substance into procedure. I spent more time covering the Senate than the House, so I may be unfair to the House. But in my experience, no matter what the issue is, it will be turned into a procedural debate culminating in a tabling motion. What is true of that in general is true in spades on budget stories. Every budget story is now a procedural story; Gramm-Rudman-Hollings is perhaps the ultimate congressional procedural story. What we have done is take the real flesh and blood and guts of American politics and turned it into a constitutional debate which is being tossed into the courts. Our challenge as reporters is to wade through the cloud of obfuscation and procedures that Congressman Slattery talked about and get down to the question of what the story is; that is a matter of specifics. That means more macroeconomic coverage, that means more in-the-street coverage. It is a big challenge.

REP. BUDDY MACKAY: Howard has just stated my major thesis. Gramm-Rudman-Hollings is not an isolated event. Gramm-Rudman-Hollings is part of an overall debate that is been going on at least for the three years I have been in Congress. Some very interesting changes have taken place in both parties in the Congress; new alliances have been formed.

The debate is being framed, not so much by the far left or the far right, but more by centrists in both parties. The House Budget Committee is working differently. There is a different coalition that made the House decide not to sandbag Gramm-Rudman-Hollings. Certainly, Connie Mack was working with us to ensure Gramm-Rudman-Hollings did not fall apart and that it was cleaned up. I do not see those things being reported and I think they are very important to my constituents who are trying to figure out if there is anything sensible going on here.

DR. ALAN GREENSPAN: As a director of a TV network I think I am going to defend the press on this issue for a moment. The problem that I think people have with economic reporting is basically the problem of the state of economics. We are not at the level of the physical sciences where the vast majority of basic principles of how the system is governed are agreed to by all of the professional practitioners. When you see an article on some new physical theory on the front page of the New York Times, as often happens, there is little in the way of dispute. The article is an effort to clarify principles essentially agreed to by all the basic practitioners. When you get to the issue of economics, the system is far more complex, and as a consequence only a relatively modest proportion of descriptions of how the system works is agreed to by, say, 90 percent of the practitioners. There is a large enough area where the evidence is ambiguous, the concepts fuzzy, and a great deal that has to be filled in by economists where there is no hard evidence. As a consequence, very fundamental disagreements emerge. Therefore, when somebody in the press endeavors to report "a story" and to do it objectively, he is caught in the dilemma of how to be objective. What you get is either "he says versus he says," which then becomes a personal debate or a conflict which is a significant amount of economic reporting -- or you get a reporter who thinks the story he just got on background from some economic practitioner is the objective story and it is reported that way. There are very few economic reporters, as I see it, with the technical background to produce anything other than the view they hear, and as a result of that, there is a great deal of confusion and a tremendous amount of superficiality in economic reporting. The only area where I think economic reporting is done well at this stage is in the Economist of London. It does well for two reasons: one, it actually has an editorial point of view. You may agree with it, or you may disagree with it. Its editorial pages go right through the whole magazine. So there is a central focus. Whether you agree or disagree, you always know where they are coming from. But if we need the news media to be objective, they have got an extraordinarily difficult job, and if we have trouble understanding what they say, it is largely because the reporters have trouble in understanding what we economists are saying.

OWEN ULLMANN: I basically agree with Alan's point, except one of the reasons we do not understand what you are saying is because another economist will call me up and say you are wrong. Then I call you and you say, "No, I am right; he is wrong." And we are back to that very ambiguous proposition.

I want to make a couple of quick points. Congressman Latta said the press has an obligation to educate the public. I fundamentally disagree. Education might be your responsibility, or maybe the

teachers'. I tend to think that it is up to the public to educate themselves. My job is to provide the information that people can use to educate themselves, but I am not in the business of trying to tell people what they should know. Secondly, Congressman Obey, I do not think quantity on Gramm-Rudman-Hollings and economic issues substitutes for quality. One of my big concerns is one Alan touched upon, the fact that in a lot of our economic reporting, we state almost as fact premises that are not necessarily true. I remember in 1980, we all said that deficits were responsible for inflation, and of course that may yet prove to be true some years down the road, but as of now, it is pretty hard to show a very direct causal relationship given that the deficits keep rising and inflation has stayed low. You could make that point about interest rates as well. One of the problems we have as reporters is to try to explain all the ambiguities about links between budgetary policy and economics, and frankly I keep throwing my hands up, because every time I think I have got an answer, someone comes up with some evidence to the contrary I cannot dispute. The third point I would make in defense of television news, even though I am a print reporter, is I think we all have to recognize that the television news really provides a group of snapshots of what happened that day. The goal is to provide us with a basic understanding of the major events and it is our responsibility as citizens in a democracy and pluralistic society to go out and find out more about those issues. There certainly is plenty of information available from newspapers and magazines and in depth television shows and radio shows.

A final point on Gramm-Rudman-Hollings. My hands are clean. I did not have to cover it. So I will speak purely from a detached personal viewpoint. I happened to speak to someone in the White House around the time the President made a decision to embrace Gramm-Rudman-Hollings and was told point blank, "You know, we were really worried the Democrats were going to kick the blank out of us on the debt ceiling, and boy this came around just at the right time. And now we are going to kick their asses." Is that an economic story? Now, subsequently, I think the dynamics changed, but that initial statement told me that White House support was based on a very political, cynical motive. I do not doubt that a lot of Members of Congress who have supported the legislation are very sincere about wanting to accomplish the end, and I do not want to sound cynical about that. What troubles me, is that we are always postponing dealing with problems. I wonder who would be willing to wager any money here that in 1991 we are going to have a balanced budget. I do not know. I do not know if the world will be around in five years. It is just too uncertain. But what about 1986? Gramm-Rudman-Hollings sets a target of what, \$172 billion for 1986? Congress has already decided that it cannot meet that target and so it will settle for something less. That does not strike me as very credible. If the public is going to look to Washington and see sincere efforts to deal with the deficit, it would like Congress at least in the first year to meet a target. Otherwise what is the point. I do not understand how we have a bill that sets a target of \$172 billion in the first year and then says, "Well, we are not really concerned with 1986; it is 1987, or 1988, or 1991." That summarizes the frustration and the confusion and the cynicism of a public much more removed from the details than we, and it explains why they throw up their hands and say, "Do not bother us until the crisis."

CAROL COX: Frankly, Owen, you just made the point that I would have made about the coverage of Gramm-Rudman-Hollings and I am surprised it was not made earlier. I could not believe in all that I read and saw about that bill how little coverage there was of the fact that Congress spent a great deal of time negotiating the 1986 deficit limit, without any intention whatsoever of meeting the target. It struck me as incredible that no one actually covered that dimension of the story.

WOODY PRICE: We may be putting a somewhat unfair burden on the press in expecting them to be the economic tutors of the American people. Economics has, accurately or inaccurately, been called the dismal science, and so I really wonder who their audience is. And as a secondary comment on Congressman Obey's survey of the press, I think there is a statistic around that something like two-thirds of the American public get all their news from television. Admittedly, the snapshot approach of TV to which Owen Ullmann referred is a particularly clumsy way of dealing with the complexity of economics or the budget, but if you had a front page economics story, would anybody read it?

REP. NEWT GINGRICH: This is fascinating. I did a conference this summer at CSIS on terrorism and the press the week of the Achille Lauro, and Dave Gergen was there. He said the most important thing he had learned in leaving the White House and becoming part of the working press was that each side has the wrong expectations of the other side. He said it finally hit him that the press has every right to run up to the President and say, "Tell us, tell us, tell us." The President has every right to say, "I got elected last year. I am in for four years. I will let you know before I leave." The press can then say the President is not cooperating and he can say they are unreasonable. So what? I repeat this observation in context of the discussion today. For about two hundred years this country has had the level of politicians and reporters it deserved. When you pay for newspapers and get free evening television shows, you should expect just about what you get. When you elect us, you get about what you deserve. Each side tends to be overly arrogant, overly pompous and take itself too seriously. Now the fact is, the New York Times in December of 1861, printed a map of every fortification around Washington and identified by unit which units were in the fortifications in the middle of the Civil War. A news media with that tradition is capable of almost anything, and on occasion rises to it. There are two very serious points we have to confront in our lifetime if we are going to remain a powerful nation capable of dealing with the information revolution. The first is, and I think Owen said it, we have a segmented, differentiated news media. You ought to watch television for what television does well. You ought to then accept the fact that television is not The Economist and it is not a scholarly tome, it is not a paperback book to read over the weekend, and it is not any variation in between. You ought to say to citizens, if you want to know on the surface what happened yesterday, watch the evening news. If you want more read your local paper. If you want to know a lot, read the Post or the Times or the Wall Street Journal. If you want to know vastly more than that about economic issues, read The Economist, and so forth. We educate ourselves by using the incredibly rich diversity of data flow. We do not expect people to know more than they know. A reporter whose entire career is divided into 90-second segments is not likely to know as

much about a specific topic as a Ph.D. who wrote five 600-page tomes. We ought to accept that and then measure each against who they are, just as you accept politicians for what we are to some extent.

The second point I would make, which I think both Alan and David began, is that every issue that matters for the rest of our lives is going to be unbelievably complicated. I tried to say this yesterday to Modigliani and Rowen. You take Gramm-Rudman-Hollings. I listed budgetary, political, economic, programmatic, and constitutional/legal issues -- all of them reported through a theological and institutional memory filter, and all in the context of a piece of legislation which was sprung suddenly and deliberately by Phil Gramm in the hopes of getting it through before anybody really understood what it said. Now in that context, there will be an information cycle that is almost predictive. The cycle runs from: "What is it?" to "What does it mean?" to "What are its implications?" to "What did we not understand about it?" to Ornstein's rule of unintended consequences, which we will learn about in the next three years. After my experiences today and last summer at CSIS, I now think that at some point a series of joint political news/media conferences like this morning's panel could help us to sort out and layer just how complicated the information flow is going to be in the 21st century. I think we would raise dramatically the expertise on both sides. We politicians are trying to govern. And I think you in the media are right when you say what you do is not education. What you try to do is to communicate accurately information, in such a way that others can educate themselves. I think we have just scratched the surface of that complexity.

DR. NORMAN ORNSTEIN: I think we should not in this discussion ignore the communications revolution that has already taken place, starting with C-Span which has wrought a revolution in American political coverage. The fact that this whole session, which is all about the budget, economics and reporting of these subjects, is being covered live and will be repeated several times, and will in the end reach an audience of millions is significant. Add to that shows like the nightly business report, the revolution on cable overall: C-Span as a show on business which covers economic and budget issues; Adam Smith's Money World is devoted to economics issues; some shows on public television, like the late-lamented Lawmakers, even cover Congress as an institution; the one-hour MacNeil-Lehrer show certainly provides more in-depth coverage than we saw in earlier years. Even the networks are giving economics reporting a higher priority. Night Line devotes some attention to these subjects; an hour show like David Brinkley spends considerable air time on budget and economics issues. There is a substantial amount of television now devoted in much greater detail to these issues than we have ever had before. These shows have significant audiences. They have audiences among a much broader group of elites, even mass audiences, than ever before. There has also been a revolution in the print medium. When you look at the coverage provided to Washington issues, including budget issues, by magazines like Fortune, BusinessWeek, and Forbes -- as well as the enhanced coverage in the wire services, the Post, the Times, and the Journal -- there has been a revolution in Washington coverage. It is both substantial and important.

The problem that remains, the significant problem, is the network news shows. That is where most people get most of their information. There has been a clear and definitive change in the way the networks cover issues. First they put competitive pressures on themselves. News divisions today are expected to pull in profits. They are no longer the loss leaders they were in earlier years. They have very real competition from cable and local stations, from outside the networks. In response, stories are getting shorter. We used to talk about two minutes. Now you seldom see a story that is more than a minute and fifteen seconds. If there is a longer story, it will have a take out focus; it is almost never on a subject that has anything to do with politics or economics or government. It is cultural in some fashion. Second, process stories are going by the boards. The networks are turning more and more toward stories on final decisions or events, forgetting a context.

As I suggested yesterday, during the month of September when Gramm-Rudman-Hollings was bubbling up and there was a lot happening, there was no reporting in context to help the public figure out what was really going on. There were no final events to cover. It was an ongoing process. The networks do not cover that kind of story. The network evening news shows have consciously decided to get away from Congress. Congress is boring; Congress is confusing; Congress just does not do very much. Despite the fact that we now have television coverage of the House floor, the network news shows seldom use the footage that is available. Thank goodness there are organizations like C-Span that can show it and pull in a heavy audience. The problem, given the audience for those network news shows, is finding a way to get something more there.

Let me add one more point. I agree with Owen that journalism does not owe an education to the public. Journalism owes explanation and context. In many cases, that is where journalism has been lacking on this issue. It is struggling to get beyond day to day events, to put them into an historical context, and to find space to provide context. I do not think that is a reporter's problem. The problem does not even exist in some places -- in the bigger and better newspapers, for example. This is an editor's problem. Editors do not want to devote attention to eyes-glaze-over stories that provide any kind of context. Something has to be done to educate producers of evening news shows, editors of newspapers and magazines, to let them know that they do have an obligation to provide this kind of context. One small additional comment: I was struck when Congressman Latta said, "Congress has no backbone. They do not do any of those things." It reminded me of the old Lone Ranger and Tonto joke: "What do you mean, we, Kemosabe?" It is not "they." I am sorry Mr. Latta had to leave. I hope he sees this on tape when it is repeated. It is "we," Congressman Latta. You are part of it.

FRANK SCHIFF: I agree with Dave Obey that the press was really to blame in not covering the macroeconomic aspects of Gramm-Rudman-Hollings. When you have two people like Walter Heller and Herb Stein, who are both very expert and very clear communicators, and who have different political backgrounds, it is not enough to say: "it was so complicated it could not be covered."

DR. SUSAN IRVING: In part, Norm made the point I want to raise. Those who object to the idea that the press has an educational role are defining the term education too narrowly. In this large a democracy, people relate to their elected officials in part through what the press tells them their elected officials are doing. That is "providing a context." Imagine the freeze that Senator Kassebaum discussed yesterday is enacted. Does the headline say, "Congress slashes social security benefits" or does it say, "Congress freezes the budget"? That makes a really big difference in the reactions from home. The media does not stand outside the process. None of you here really believe you just report, that you do not affect reality. You do affect reality, and you have a responsibility to present issues in a way people can understand.

In response to Congressman Obey, I think that by the time the House considered Gramm-Rudman-Hollings it was already too late to make the point about the procyclical nature of the legislation. In order to explain that Gramm-Rudman-Hollings overrides the automatic stabilizers built into the budget, you need sometime along the way to have taught the American people that we have built into the budget automatic stabilizers -- that the deficit automatically goes up in a recession and falls in periods of recovery. I do not think most Americans understand that. So how do you explain: one, the new law would change that; and, two, that it matters? It makes it a very complicated story.

STEVE WILDSTROM: I have spent the last ten years trying to make sense of macroeconomic policy in Washington for BusinessWeek. During that time, I think the economics press, along with the economics profession, has suffered from a steady erosion of confidence in our ability to connect policy actions to economic consequences. This is part of what Alan was talking about. The profession itself has lost its bearings in a very real way. Yesterday, Franco Modigliani said we could easily absorb a \$100 billion cut in the deficit next year, which seems to be in contrast to what he said when he was speaking to Dave Obey's committee. Other people are saying that cutting \$70 billion will cause a recession. This debate does not even break any more along the conventional or expected ideological lines of the profession. How can you blame the poor economics reporters, even those with a technical background, for being confused? All we can really do at this point is report the argument among economists. That is a very uninformative way to do things. Editors do not like it, and it is very hard for us to impose our own views on the story, because we also are confused.

JUNE CROSS: Every morning the question that comes up with our editor is: "What is driving the story today?" When you answer that question as a reporter, you consider whether it is primarily economics or primarily politics which is driving the story today, as it relates to our "snapshot" approach. I have to say that most of the time on Gramm-Rudman-Hollings politics was driving that story. If the Congress wants us to cover the economic assumptions, Congress needs to base more of their arguments on economics. If economics is the debate on the floor and in the subcommittees, that will be reflected in the press. You ask us to educate more than we can, if you expect us from the outside to interject into the story the economic slant, when there are so many different political implications in a story. In a newspaper, the

political story can be on the front page with an economic story someplace else. But television that does not have that capability. We rely on people who know what they are talking about to describe what the issue is. If those people talk about political considerations, then that is how the story is going to get played.

CAROL COX: Jim McIntyre points out to me -- and this is just too good to miss in the context of this discussion -- yesterday's Wall Street Journal headline says: "Critics Say, US Economic Picture is Blurred by Reliance on Bad Data."

DAVID LIGHTMAN: One point here that I think has been missed is the perspective of small bureaus like ours. We are three people so we are big enough to cover these issues, not in the depth of the Washington Post or the Knight-Ridder papers, but we have the sophistication and the manpower to do more than simply get reaction from our congressional delegation. And it may be instructive to note that for us, Gramm-Rudman-Hollings was at first a political story. We first picked it up when our two Senators, Dodd and Weicker, turned out to be where you would not expect them to be. Senator Dodd sided with a lot of Republicans in being for Gramm-Rudman-Hollings, and Senator Weicker was against it. Then, again because we are a small bureau, while we followed Gramm-Rudman-Hollings, we did not write about it because there were other issues. In September, for example, trade was the issue. In late November and early December, we had to concentrate a lot of our energies on tax reform. We wrote a lot on Gramm-Rudman-Hollings after it passed, and we did a long analysis of what it meant to the State, program by program: "Here is what the potential 4.6% cut might mean...." The only point I want to make is this: I think a lot of people get their news in depth about Gramm-Rudman-Hollings from papers like ours that blanket our States and have Washington bureaus.

SUSAN KING: I was taken by the fact that Howard talked about the reporter's job was to put the flesh and blood on the story, and in television we are more apt to do that. Even though we can use graphics and graphs to display, for instance, the distribution of cuts, what we tend to do is try to make it a human story. Often a budget story is really a story about the role of government. What we do is go out and tell people as dramatically as possible what the cuts are going to mean. That means getting mommy and the kids to talk about day care or health care. It means tears on the camera, and it makes it very difficult for the politicians.

REP. DAVID OBEY: I do not believe that news people have an obligation to be the economics tutor for the nation, but I do believe they have the obligation to let people know that a debate is going on in terms other than who is going to get what, because if you do not do that public opinion is going to be summed up in cliché form. The public is going to think that the only economic question that matters is whether there is a balanced budget or not. There will be no consideration of what leads to growth, no consideration of what other factors make the economy work. I recognize television has a lot of problems. CBS news, however, killed Phil Jones' story when the House finally disposed of Gramm-Rudman-Hollings after a month of debate. CBS did not even

carry the story about what was contained in the alternative because it was killed in New York. I happen to think that is an outrageous dereliction of duty.

The other point I would make is that I think Norm Ornstein is right on when he says that it is the networks that are the principal problem. I make it a point never to deal with network television; it is far more productive in terms of educating the public if you deal with the print press and take what time you have to deal with them as a political practitioner. I agree with the Neil Postman assessment that television is a medium that presents information in a form that renders it simplistic, nonsubstantive, nonhistorical, and noncontextual; it packages information as entertainment, and that is why when I see the numbers presented by Norm Ornstein about the fact that Congress is less covered by the networks, it does not bother me at all because when they do cover us, they do not cover us well.

HELEN DEWAR: I would like to try and answer the two questions that were asked. Mr. Ash asked if we have any independent sources for judging what we are told. The problem frequently is that the more important the numbers are, the less access we have to independent corroboration. About all you can do is apply what background and knowledge you have to get the range of possibilities cited by economists and politicians, so you express skepticism in the stories. You try to convey that a lot of the projections are built on shifting sand, on political argument rather than objective fact, and are subject to change; you try not to mislead the reader or viewer into thinking that this is an objective fact.

The second question is: If Gramm-Rudman-Hollings falls through, is there is enough of a momentum to keep deficit reduction going? One thing driving a number of Members of Congress is fear that they are building a level of expectation among the public -- and if something is not done, sooner or later voters are going to begin to measure incumbents on the basis of promises unfulfilled. Maybe there will be a change from what Owen found a couple of years ago; they may begin to turn Members out of Congress when the Members promise and fail to deliver. There is a strong level of fear or apprehension that this may be building for this election, or for 1988. You could reverse the tendency to reelect incumbents and start throwing people out regardless of party on that issue as much as anything else.

OWEN ULLMANN: To turn to the role of the media in shaping the public's attitudes about the budget and the economy: I think that people probably get most of their feelings about the economy and how government is doing from their real world experience, from how things are in their lives. Then they may try to decide whether the government is responsible, either in terms of blame or credit. I think we give ourselves (the media) too much credit or too much responsibility for shaping opinions. I think we are just part of the millions of random dots of information and facts that go through peoples lives. We are really a pretty small part of it, I think as Newt Gingrich said, we should not take ourselves too seriously.

One final point about the status of the budget and the deficit, I am

convinced that if the public as a body finally decides that the deficit is bad enough that it really needs to be reduced by taking some tough measures, then tough measures will be taken and the deficit will be reduced. When the public sees chaos coming, and they are convinced the deficit is the problem, Congress and the President will have the backbone to do the public's bidding even if that means deep spending cuts and/or tax increases. On the other hand, as long as people believe things are pretty good, as long as people think there is nothing wrong with continuing to have a free lunch, I do not see why the Congress and the President would not continue serving it.

CAROL COX: Buddy MacKay, does the norm of budget balance matter? Do you all have the backbone? Will you do what has to be done to move the budget back toward balance with or without Gramm-Rudman-Hollings? You have two minutes. We are almost out of time.

REP. BUDDY MACKAY: Carol, I am from the South and I cannot say that much in two minutes. Let me frame my response to Carol's questions this way. Gramm-Rudman-Hollings may well be thrown out. I do not particularly get wrapped up in esoteric constitutional issues. The fact of the matter is, Gramm-Rudman-Hollings is part of an overall, ongoing debate about the role and scope of Government. That debate is not going away. The issue finally is coming into focus in a way the people of America can understand. They are going to insist that something be done. I think the key thing about Gramm-Rudman-Hollings is that it has compressed the time period and that may break us out of a stalemate. It is one step in an ongoing process.

PAUL DUKE: To the question, do we use independent sources? I would say that by and large almost all good reporters do, and if they do not, they certainly should pursue independent sources. Something else in Washington which is very helpful in particular with the coverage of important stories on Capitol Hill, are the institutional observers such as Norm Ornstein that we can tap, because they keep a close eye on all the major developments and all the major personalities. I think most good reporters keep in touch with people like Norm, for example. Are we skeptical enough? I would hope we are, but obviously there are times when we are not skeptical enough. I think it is certainly a good rule for every reporter to be skeptical of his approach, whenever he is covering a major story in pursuit of the truth. Having sat here and listened to all the observations this morning, Carol, I just have to say, thank God for the first amendment. One overwhelming impression I come away with is a reinforcement of my view: that almost everybody has a grand design for the press. Each wants to use the press for his or her purpose; either they want us to educate the public or to cover those things which they feel specifically should be covered. Many of those things could be noble and noteworthy. I would just add that basically, even though education is a byproduct of what we do, that is not our basic function. Our basic purpose and function is to inform, to explain, and to shed as much light and truth as possible on the things which we cover. I think Congressman Slattery is quite correct when he said a while ago that our job is made infinitely more difficult by the fact that there are people who deliberately try to mislead and confuse us. That can never be overlooked as a factor in our reporting. I think Newt

Gingrich made an important point, too, when he suggested that there are gradations to the coverage. If you want a smattering of what happened, there is the nightly news. The nightly news, after all, is an illustrated headline service more than anything else. For the person who wants more, there is the New York Times, there is the Los Angeles Times, there is the Washington Post, and the news magazines which are doing a much better job these days. There is MacNeil-Lerher, which has provided extensive background reports on the budget fight, and there are the specialized programs on public broadcasting. On the whole, I think that we are doing a better job, so I stick to my main thesis.

CAROL COX. This meeting seems nearly unanimous: the norm of budget balance does matter. We may not have solved the deficit problem; but we agree the deficit is a problem. More than that, I know because you have told me, we agree that meetings such as this one can help solve the deficit problem. The importance of this meeting is that so many people, representing so many divergent views and constituencies, agree we need to do something -- and we have begun to discuss what can and should be done. Our Committee only hopes this group and others like it will continue to meet. We thank our cosponsors once again for helping to make this meeting possible. With that, the symposium is adjourned.

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